Supreme Court, U.S.
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No.

In The
Supreme Court of the United States

RICHARD NICHOLAS, et al.,
Petitioners,

v.

SAUL STONE & COMPANY, LLC, et al.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In this case, the District Court for the District of New Jersey held, in relevant part, as follows: (i) that the Petitioners do not have a private remedy for violations of National Futures Association ("NFA") bylaws and rules, in particular NFA Bylaw 1101 - the NFA's "cornerstone" of self-regulation for the protection of the public interest; and, (ii) that the NFA may not be held liable pursuant to 7 U.S.C. §25(b)(2) unless it fails to enforce a bylaw or rule required under 7 U.S.C. §21 and determined, further, that NFA Bylaw 1101 is not such a required bylaw. The Third Circuit Court of Appeals, without specific reference or discussion, adopted the conclusions reached by the District Court with respect to each of these issues. The questions presented are:

1. Do investors in commodities futures contracts have a private cause of action against NFA Members for damages resulting from violations of NFA Bylaw 1101?

2. Is NFA Bylaw 1101 an intended requirement of the Commodity Exchange Act ("CEA")?

PARTIES TO THE PROCEEDING

Petitioners

Richard Nicholas; Lynn Nicholas; Robert M. Blackburn; Cheryl S. Blackburn; On Behalf of Themselves and On Behalf of the Class of All Others Similarly Situated.

Rule 29.6 Corporate Disclosure Statement

Petitioners are not corporations, but consist of individual persons. Therefore, no parent or publicly held company owns 10% or more of the stock of Petitioners, as such is not applicable.

Respondents

Saul Stone & Company LLC f/k/a Saul Stone And Company; First Options of Chicago, Inc. d/b/a LIT Division of First Options; Smith Barney, Inc.; LFG, LLC f/k/a Linnco Futures Group, Inc.; Dean Witter Reynolds, Inc.; ING (U.S.) Securities Futures & Options, Inc. d/b/a ING Futures & Options; Merrill Lynch, Pierce, Fenner & Smith, Inc.; Prudential Securities, Inc.; Rosenthal Collins Group, L.P. f/k/a Rosenthal & Company; E.D. & F. Man International, Inc. f/k/a E.D. & F. Man International Securities, Inc.; and, National Futures Association.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

PARTIES TO THE PROCEEDING ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES vii

OPINIONS BELOW xi

JURISDICTION xi

STATUTORY AND RULE PROVISIONS INVOLVED xii

STATEMENT OF THE CASE 1

A. Statutory Background 2

B. Registration Of The NFA 4

C. Factual Background 7

D. Proceedings Below 9

REASONS FOR GRANTING THE PETITION 9

ARGUMENT I:
THE SUPREME COURT SHOULD RESOLVE THE CONFLICT OVER NFA BYLAW 1101 IN FAVOR OF A PRIVATE CAUSE OF ACTION 11

A. The Courts Are Divided On The Impact Of NFA Bylaw 1101 And The Right Of A Private Investor To Pursue A Cause Of Action For A Violation Thereof 13

B. Investors Are Entitled To A Private Cause Of Action For Damages Resulting From Violations Of NFA Bylaw 1101 15

1. NFA Admits Regulatory Intent To Allow Private Right To Enforce Bylaw 1101 17

2. NFA Bylaw 1101 Is A Specific Rule For The Public's Protection 18

C. Commodity Ponzi Schemes Flourish Under Present State Of Regulatory Controls – Outcome Important To National Public 21

ARGUMENT II:
NFA BYLAW 1101 IS A REQUIRED RULE PURSUANT TO THE STATUTORY INTERPRETATION OF 7 U.S.C. §21 22

ARGUMENT III:
ENFORCEMENT OF NFA BYLAW 1101 SHOULD BE CONSISTENT WITH THE ADMINISTRATIVE PROCEDURES ACT 25

CONCLUSION 28

APPENDIX

Appendix A
Court of Appeals Judgment and Opinion, 8/7/00 . . . . . 1a

Appendix B
U.S. District Court Order and Opinion, 6/30/98 . . . . . 31a

Appendix C
(Excerpts from) Commodity Futures Trading Commission Order, 1981 . . . . . 92a

Appendix D
Court of Appeals for the Seventh Circuit Brief of Commodity Futures Trading Commission *Amicus Curiae*, 3/30/98 . . . . . 121a

Appendix E
Superior Court of New Jersey Letter Opinion, 10/31/96 . . . . . 137a

Appendix F
Articles of Incorporation of National Futures Association, Article II: Purposes . . . 143a

Appendix G
NFA Bylaw 1101, Chapter 11, Doing Business with Non-Members, CFTC Reg. § 166.3 . . . . . 145a

Appendix H
Compliance With Bylaw 1101. Interpretive Notice 147a

Appendix I
NFA Compliance Guide 151a

Appendix J
7 U.S.C. § 21 . . . . . 154a

Appendix K
7 U.S.C. 25(b)(2), (3), (4) & (5) 179a

Appendix L
(Excerpts from) Futures Trading Act of 1982 181a

TABLE OF AUTHORITIES

Cases — Page(s)

Acampora v. Prudential Bache Securities, Inc.,
[1986]-1987 Transfer Binder] Comm.Fut.L.
Rep. (CCH) ¶23,792 (C.F.T.C. 1987) 15

Block v. S.E.C.,
50 F.3d 1078 (D.C. Cr. 1995) 27

Board of Trade of City of Chicago v. S.E.C.,
883 F.2d 525 (7th Cir. 1989) 27

Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
410 F.2d 135 (7th Cir. 1969), cert. denied,
396 U.S. 838, 90 S.Ct. 98 16

Cardoza v. CFTC,
768 F.2d 1542 (7th Cir. 1985) 26, 27

City of Bayonne v. North Jersey, etc., Commission,
30 N.J. Super. 409, 105A.2d 19
(App. Div. 1954) 23

Colonial Realty Corp. v. Bache & Co.,
358 F.2d 178 (2d Cir. 1966), cert. denied,
385 U.S. 817, 87 S.Ct. 40 . . . . . 15, 16

Cort v. Ash,
422 U.S. 66, 95 S. Ct. 2080 . . . . . 11, 19, 20

Equidex, Inc. v. National Future Association,
Superior Court of New Jersey, Law Division,
Hudson County, Docket No. HUD-L-9424-92(1) 19

Harvey v. Essex County Board of Freeholders,
30 N.J. 381, 153 A.2d 10 (1959) 23

Heckler v. Chaney,
470 U.S. 821 (1985) 26

Hiller v. Securities And Exchange Commission,
429 F. 2d 856 (2d Cir. 1970) 28

Idahoan Fresh v. Advantage Produce, Inc.,
157 F.3d 197 (3d Cir. 1998) 23

Indemnified Capital Invs., S.A. v. R.J. O'Brien
& Assoc., Inc.,
12 F.3d 1406, (7th Cir. 1993) 14, 15, 16, 17

Matter of Lake States Commodities, Inc.,
936 F.Supp. 1461 (7th Cir. 1993) 13, 14

Merrill Lynch, Pierce, Fenner & Smith v. Curran,
456 U.S. 353 (1982) 12, 15

National Railroad Passenger Corporation v.
Boston And Maine Corporation,
503 U.S. 407 (1992) 24

Peltz v. SHB Commodities, Inc.,
115 F.3d 1082 (2d Cir. 1997) 13

Porter v. Shearson Lehman Brothers, Inc.,
802 F. Supp. 41 (S.D. Texas 1992) 14, 15

Sam Wong & Son, Inc. v. N.Y. Mercantile Exchange,
735 F.2d 633 (1984) 25, 26

Spicer v. Chicago Board of Options Exchange, Inc.,
977 F.2d 255 (7th Cir. 1992) 14

Statutes

7 U.S.C. §1 1
7 U.S.C. §5 2
7 U.S.C. §6b 15
7 U.S.C. §6d 3, 12, 20
7 U.S.C. §6e 3, 12, 20
7 U.S.C. §6k 3, 12, 20
7 U.S.C. §6n 3, 12, 20
7 U.S.C. §19 . . . . . 2, 4
7 U.S.C. §21 . . . . . *passim*
7 U.S.C. §21(b)(1) 2, 5, 24
7 U.S.C. §21(m) . . . . . *passim*
7 U.S.C. §25 12
7 U.S.C. §25(a) 9
7 U.S.C. §25(b)(2) . . . . . xi, 22, 26
7 U.S.C. §61 2
28 U.S.C. §1254(1) x
17 CFR §4.21 7
17 CFR §4.24 7

Regulations And Rules

NFA Bylaw 1101 . . . . . *passim*
NFA Compliance Rule 2-30 . . . . . 10, 17
Securities Exchange Act of 1934 14

Other Authorities

Futures Trading Act of 1982, Pub.L. 97-444
House Report No. 97-565, Part I, page 57 . 11, 12

Petition For A Writ Of Certiorari

Richard Nicholas, Lynn Nicholas, Robert M. Blackburn and Cheryl S. Blackburn, respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The Opinion of the United States Court of Appeals for the Third Circuit dated August 7, 2000 (Pet. App.[1], 4a - 30a) is unpublished. The Opinion of the District Court for the District of New Jersey dated June 30, 1998 (Pet. App., infra 33a - 91a) is unpublished.

JURISDICTION

United States Court of Appeals for the Third Circuit issued its Judgment on August 7, 2000 (Pet. App. 1a - 3a) and its Opinion (Pet. App. 4a – 30a). This Petition for Writ of Certiorari is filed within Ninety (90) days of the Opinion and Judgment of the Third Circuit. The Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

[1] Citations to "Pet. App." Are to the appendix filed with this Petition for Writ of uant to Supreme Court rule 14(i).

STATUTORY AND RULE PROVISIONS INVOLVED

The pertinent rule and statutory provisions are reproduced in the Appendix. The rules involved are NFA Bylaw 1101 and its related Interpretive Notice (Pet. App. 147a). The statutes involved are 7 U.S.C. §§21 (Pet. App. 154a - 178a), 25 (b)(2) (Pet. App. 179a).

STATEMENT OF THE CASE

This case presents questions of broad practical importance to the administration of the CEA, 7 U.S.C. §1, et seq., and the self-regulatory scheme created thereby. The Third Circuit and the District Court effectively set aside and ignored the underlying purpose of the CEA without acknowledging the legislative intent and proper statutory construction in favor of a superficial and mechanical result. Its reading effectively renders self-regulation to become no regulation, by prohibiting the public, for whom the CEA is to protect, the right to a private cause of action for damages caused by NFA Members for violations of its Bylaw 1101, set forth at Pet. App. 145a.

The essence of NFA Bylaw 1101 prohibits any NFA Member from conducting customer business with a non-member that is required to be registered. Mandatory membership in the NFA is the "cornerstone" of NFA's regulatory structure. Anyone who accepts orders, money, or securities for the purpose of effectuating a purchase or sale of a commodity futures contract must register with the NFA.

The Third Circuit further extends the theme of no regulation by disallowing Petitioners the right to sue the NFA for its failure to enforce said Bylaw and determining that NFA Bylaw 1101 was not required by the CEA pursuant to 7 U.S.C §21. The Commodity Futures Trading Commission ("CFTC") Order of 1981 (Pet. App. 92a – 120a) in granting registration and approving rules of the NFA as a registered futures association, substantially relied upon the compulsory language of NFA Bylaw 1101. The Third Circuit ignored the CFTC Order of 1981 and the discussion therein regarding Bylaw 1101.

A. Statutory Background

The statutory policy behind the enactment of the CEA is to protect the **national public interest** through the registration of those persons accepting an order or handling a transaction in commodity futures contracts. "Transactions in commodity involving the sale thereof for future delivery as commonly conducted on boards of trade and known as 'futures' are affected with a national public interest." 7 U.S.C. §5. Likewise, Congress determined in 1974, Pub. L. 93-463, "that the activities of ... commodity pool operators are affected with a national public interest ... ." 7 U.S.C. §6l. The Congressional intent continued in consistent form and substance as part of 7 U.S.C. §21(b)(1) disallowing the registration of a futures association unless the CFTC finds that such association is in the public interest.

Congress first enacted 7 U.S.C. §21, Registered Futures Association, in 1974 without Subsection (m), as it exists today. Subsection (m) was added to 7 U.S.C §21 in 1978 as part of Pub. L. 95-405, §22(4), with former Subsection (m) redesignated as Subsection (n).

The creation of Subsection (m) was in response to the NFA's initial failed application for registration as a futures association pursuant to 7 U.S.C. §21, as such was deemed not to be the least anti-competitive means of achieving the objectives of the CEA. The CEA requires the CFTC to balance various statutes in its quest to approve a registered futures association and its bylaws, rules or regulations. 7 U.S.C. §19 reads:

> "The Commission [CFTC] shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the

objectives of this chapter, as well as the policies and purposes of this chapter, ... in requiring or approving any bylaw, rule, or regulation of a ... registered futures association pursuant to §21 of this title."

7 U.S.C. §21(m) reads:

"Rules requiring membership in associations -

"Notwithstanding any other provision of law, the Commission [CFTC] may approve rules of futures associations that, directly or indirectly, require persons eligible for membership in such associations to become members of at least one such association, upon a determination by the Commission that such rules are necessary or appropriate to achieve the purposes and objectives of this chapter (CEA)."

The CFTC has primary responsibility to administer and enforce the CEA. The approval by the CFTC of NFA Bylaw 1101, a rule prohibiting NFA Members from doing business with non-members, was a reaffirmation of the statutory intent of the CEA, 7 U.S.C. §§6d, 6e, 6k and 6n, requiring defined participants in the futures industry to register with the CFTC. In the case of 7 U.S.C. §6d, futures commission merchants ("FCM" or collectively "FCMs") are required to register with the CFTC before soliciting or accepting orders to trade commodities, futures contracts and commodity options.

B. Registration Of The NFA

On January 15, 1977 the CFTC received a document entitled "National Futures Association Organizing Committee - Points of Agreement." Thereafter, on June 7, 1977, the CFTC received a statement from NFA's organizers in favor of compulsory [NFA] membership. The CFTC voted to approve the following statement:

> "The Commission [CFTC], as a matter of policy, approves the concept of `uniform required membership' (emphasis added) as proposed by the NFA organizing committee. This approval is stated in the abstract, ... , and would be the basis for the proposed NFA structure, ..."

Such uniform required membership served as the basis for NFA Bylaw 1101. The submission by the NFA's organizers was regarded as an application for registration and was addressed by the CFTC on October 7, 1977 in a document entitled, "In The Matter Of: The National Futures Association, Comments of the United States Department of Justice." The initial proposal by the NFA was deemed to be anti-competitive pursuant to 7 U.S.C. §19 (see Pet. App. 110a - 114a).

Subsequent to the enactment of Subsection 21(m), on March 16, 1981, the NFA again submitted an application to the CFTC for registration as a registered futures association under 7 U.S.C. §21 of the CEA. The CFTC entered an Order in 1981 Granting Registration And Approving Rules, In the Matter of the Application of the NFA (the "CFTC ORDER") (Pet. App. 92a). The CFTC noted in the CFTC ORDER at pages 4 and 5 (Pet. App. 93a) thereof, entitled "Overview of NFA Application, A Structure of NFA," the following:

> "The NFA has determined that in order for it to exercise its regulatory authority effectively, membership in the NFA ... should be compulsory (emphasis added) for FCMs and their agents, CPOs and CTAs. The rules do not explicitly compel such membership, but proposed bylaw 1101 would prohibit NFA members from carrying accounts, accepting orders, or handling accounts for or on behalf of any ... non-member (emphasis added) of the NFA who is not a member of another registered futures association, unless such person is exempted from the provisions of bylaw 1101 .... In addition, bylaw 301 would require APs of FCMs to register with the NFA as `associates.' Consequently, each step in the order-handling process leading to execution by a floor broker ... would have to be effected through an NFA member or a person subject to the NFA regulation." Pet. App. 93a - 94a.

The cumulative effect of the NFA's rules and the regulatory functions is to demonstrate that the CFTC's registration of the NFA will benefit the public interest. Pet. App. 100a. "Requiring membership in a registered futures association is an essential factor in providing the effective, industry-wide customer protection that the NFA proposes." Pet. App. 114a. The NFA's compulsory membership requirement was substantially the same before and after the enactment of 7 U.S.C. §21(m).

7 U.S.C. §21(b)(1) prohibits the CFTC from registering the NFA unless it is able to find that the NFA "is in the public interest (emphasis added) and that it will be able to comply with

the provisions of this section [§21] and the rules and regulations thereunder to carry out the purposes of this section [§21]." Pet. App. 155a.

The CFTC believe[d] that the commodities industry is not only prepared to assume, and capable of exercising, self-regulatory responsibility with respect to the activities of industry participants, but also better equipped to devote the resources necessary to significantly reduce the considerable number of customer abuses that have occurred in the absence of effective self-regulation. "The effectiveness of this approach, however, would be jeopardized if the NFA did not have provisions which, in effect, compel (emphasis added) NFA membership by industry participants." Pet. App. 104a. In approving the NFA's registration, the CFTC approved the NFA's compulsory membership requirement of Bylaw 1101 as necessary and/or appropriate to achieve the purposes of the CEA, pursuant to the CFTC's authority under 7 U.S.C. §21(m). In the NFA's case, the compulsory membership requirement is indirect, i.e. members cannot conduct business with non-members. Pursuant to NFA Bylaw 1101, once joining the NFA, members would be prohibited from engaging in any customer-related business with, or on behalf of, any non-member (or suspended member) FCM, CPO, CTA, or agent that is neither a member of another registered futures association nor otherwise exempted from this prohibition. Pet. App. 109a - 110a.

The CFTC determined that "Requiring membership in a registered futures association is an essential factor (emphasis added) in providing the effective, industry wide customer protection that the NFA propose[d]. If membership were purely voluntary, those engaging in abusive practices could evade self-regulatory compliance and sanctions simply by not joining, or by resigning from, the NFA or any comparable

organization," Pet. App. 114a [2] (like Kohli, Chandran and the Sigma Entities in the case at bar).

C. Factual Background

The Petitioners are a class of individual investors (400 persons in all) who were defrauded out of approximately $41 million dollars during the period of January 1, 1989 through April 12, 1995 in a Ponzi scheme designed and executed by Charles Kohli (at all times herein referred to as "Kohli"), Ram Chandran (at all times herein referred to as "Chandran") and through various commodity pools collectively known as and at all times referred to herein as the "Sigma Entities." Kohli, Cahndran nor the Sigma Entities were NFA members. Respondent FCMs were at all relevant times NFA members. The majority of these funds were placed with Respondent FCMs to trade commodities, futures contracts and commodity options. Pet. App. 41a.

All FCM Respondents admit to trading with a non-member in violation of NFA Bylaw 1101. The FCM Respondents failed to conduct due diligence, make inquiries and obtain required Disclosure Documents pursuant to 17 CFR §§4.21 and 4.24 with respect to the NFA membership status, financial condition and source of the deposited funds of Kohli, Chandran and the Sigma Entities, Pet. App. 42a and 46a, as required in part by NFA Bylaw 1101.

As of the date of this Petition for Writ of Certiorari, the NFA has failed to discipline any of the Respondent NFA

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[2] Such is the result in the case at bar under circumstances where the NFA fails and refuses to enforce NFA Bylaw 1101.

members for violations of Bylaw 1101. Despite the fact that Respondents FCMs carried accounts, accepted orders and handled transactions on behalf of parties not members of the NFA – no disciplinary action has been taken by the Respondent NFA and no thorough, diligent and vigorous investigative action has been initiated by the NFA concerning the management and conduct of the FCM Respondents. Pet. App. 47a. In particular, the Respondent Saul Stone & Company LLC was previously involved in two similar "Ponzi" schemes. In September 1982 and thereafter, in June 1985 Saul Stone & Company LLC received actual notice of Ponzi schemes in which it was the acting FCM. Pet. App. 47a. The NFA also failed to discipline Saul Stone & Company LLC in both previous instances, notwithstanding the strict liability standard of NFA Bylaw 1101.[3]

There are no facts in dispute regarding the violations of Bylaw 1101 or the inaction of the NFA to discipline Respondent Members for such violations.

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[3] Although not parties to this Petition, the individual defendants, Thomas H. Stone ("Stone") and Clarence Delbridge, III ("Delbridge") were employed in executive positions with Saul Stone & Company LLC. Stone was a Member of the NFA and an elected member of the Advisory Committee of the NFA for FCMs. Delbridge was a NFA Member and an elected member of the Regional Business Conduct Committee of the NFA for the Central Region. Initially, the Regional Business Conduct Committee's role was to engage in fact-finding and recommending disciplinary actions. Its role was later changed to determining whether regulatory actions should be brought against NFA Members. In either case a conflict of interest exists.

D. Proceedings Below

On February 13, 1997 Petitioners filed a Class Action Complaint and thereafter, a First Amended Class Action Complaint on November 23, 1997 in the District Court for the District of New Jersey seeking recovery of losses from Respondent FCMs, the NFA, and individuals Clarence Delbridge, III and Thomas H. Stone for violations of NFA Bylaw 1101, 7 U.S.C. §§21, 25(a) and (b) of the CEA, breach of contract and other statutory and common law claims. The District Court had jurisdiction because the action arose in part under the CEA and other Federal questions.

A unanimous panel of the Third Circuit (Roth and Rendell, Circuit Judges and Pollak, District Judge sitting by designation) Affirmed the judgment of the District Court of June 30, 1998. Pet. App. 1a – 3a.

REASONS FOR GRANTING THE PETITION

The Third Circuit, by adopting the findings and opinions of the District Court (Pet. App. 29a – 30a) has cut the CEA loose from its legislative purposes in important respects that warrant review by the Supreme Court.

The underpinnings of the CEA require registration of participants in the futures industry for the national public interest. The Third Circuit - in conflict with the Second Circuit – held that Bylaw 1101 should only be enforced by the NFA. The Northern District of Illinois, Eastern Division, although relied upon by the District Court and the Third Circuit in the case at bar, recognized that NFA Bylaw 1101 was a rule of great importance, but received less than persuasive justification for reaching a different outcome. On the other hand, the Second Circuit required a reasonable inquiry. Consistent with

the Second Circuit, the CFTC, through an Administrative Action, acknowledged that compulsory membership is a must and may render a respondent liable for damages, while also welcoming private actions.[4]

The legislative intent of the CEA as well as the NFA interpretation of Bylaw 1101 clearly indicate that Bylaw 1101 is the cornerstone of self-regulation in the commodities markets and is intended to protect the public. It is a specific rule with acknowledged importance. The NFA publicly represents an intent to impose "strict liability" for Bylaw 1101 violations. Pet. App. 148a. The NFA admits the right to pursue a private cause of action for a violation of a NFA bylaw or rule by specifically disallowing such a right in the Interpretive Notice for NFA Compliance Rule 2-30. There would be no such notification where no such right otherwise exists.

Simply put, the public is not protected against commodity frauds and Ponzi schemes as intended by the legislature under the CEA. There has been no CFTC intervention on behalf of the public. To the contrary, the CFTC asserts it lacks resources to prosecute on behalf of the public interest and maintains that the public's only recourse is its private right of action. " ... private rights of action are an important supplement to government enforcement actions in helping to ensure lawful conduct in the commodities industry." Pet. App. 135a.

The facts of this case demonstrate the lack of NFA enforcement of Bylaw 1101. The NFA incorrectly argues that

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[4] See Argument I.A. at page 13, inra., for specific case references.

Bylaw 1101 is not a rule required by 7 U.S.C. and therefore it has no liability.

If the CFTC lacks resources to enforce, and the NFA refuses or simply fails to enforce, then the public must have a private right of action to enforce. Without a private right of action for Bylaw 1101 violations, there simply is no meaningful regulation. The CEA and the NFA Bylaw 1101 are impotent.

The Court's review is warranted to resolve the conflicts among the judiciary, regulatory bodies, legislative intent and association rule enforcement in conjunction with this Court's re-evaluation of Cort v. Ash, 422 U.S. 66, 95 S. Ct. 2080, 45 L. Ed. 2d 26 (1975), its progeny, and to forestall further deterioration of the CEA for customer protection.

ARGUMENT I:
THE SUPREME COURT SHOULD RESOLVE THE CONFLICT OVER NFA BYLAW 1101 IN FAVOR OF A PRIVATE CAUSE OF ACTION

The inclusive legislative intent of the Futures Trading Act of 1982 (Pet. App. 181a) is in conflict with the conclusion of the District Court as adopted by the Third Circuit.

The refusal to allow Petitioners to pursue a private cause of action due to a violation of NFA Bylaw 1101 frustrates the Congressional goal to protect the investing public. The narrow view taken by the District Court and adopted by the Third Circuit ignores the fact that private rights of action supplement, but do not substitute for the regulatory and enforcement program of the CFTC and self-regulatory agencies like the NFA. "The Committee [Congress] fully expects that these agencies [the NFA] will vigorously use the tools at its

command to protect the investing public so that it does not become necessary to rely on private litigants as a policeman of the CEA." Pet. App. 184a. Futures Trading Act of 1982, Pub.L. 97-444; House Report No. 97-565, Part I, page 57. The right of an aggrieved person to sue a violator of the CEA[5] is critical to protecting the public and fundamental to maintaining the credibility of the futures market. Pet. App. 185a.

In plain language, Congress created a private cause of action pursuant to 7 U.S.C. §25, "to avoid suits for speculative damages to assets that are affected by fluctuations in prices on the commodity market but which are not the subject of transactions on such market." Pet. App. 184a. The legislative intent was clearly not an attempt to otherwise limit Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353 (1982), but in response to it. This is further confirmed by the CFTC's welcome of private litigants for the enforcement of the CEA. Pet. App. 135a. NFA Bylaw 1101 is the corollary to and companion of the statutory make-up of the registration provisions of the CEA, 7 U.S.C. §§6d, 6e, 6k, and 6n. As such Congress intended Bylaw 1101 to be mandatory and enforced by private litigants as an additional mechanism to avoid fraud by non-members of the NFA.

Congress's simple objectives are thwarted by the decision challenged by this Petition. We ask the Court to review the conflicts and the importance of the issues by granting the Petition.

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[5] NFA Bylaw 1101 is required and created pursuant to the CEA.

A. The Courts Are Divided On The Impact Of NFA Bylaw 1101 And The Right Of A Private Investor To Pursue A Cause Of Action For A Violation Thereof

The Opinions of the Third Circuit and the District Court for the District of New Jersey ignore Peltz v. SHB Commodities, Inc., 115 F.3d 1082 (2d Cir. 1997). The Second Circuit's decision in Peltz is consistent with the fundamental purpose of the NFA (Pet. App. 143a), requirements of NFA Bylaw 1101 (Pet. App. 145a) and its Interpretive Notice (Pet. App. 147a) and allows for a cause of action against an NFA Member, where there is a failure by a futures commission merchant to perform minimal due diligence. The conflict between the Third Circuit and the Second Circuit in Peltz is easily recognized.

Generally, before accepting trades from a third party, the FCM must make a reasonable inquiry into the nature and extent of the individual's authority. Peltz v. SHB Commodities, Inc., 115 F.3d 1082 (2d Cir. 1997). Likewise, if the third party is required to be a Member of the NFA the FCM must make a reasonable inquiry into same as well, which was not done by the FCMs of Kohli, Chandran and the Sigma Entities herein.

It is crystal clear from the legislative history that NFA Bylaw 1101 is more than a membership rule. It is the single most important requirement of the CEA and is recognized as the cornerstone of self-regulation. However, the Second Circuit in Peltz, the Third Circuit in the case at bar and the Northern District of Illinois, Eastern Division, in the Matter of Lake States Commodities, Inc., 936 F. Supp. 1461 (7th Cir.

1996) are at odds regarding liability under NFA Bylaw 1101 or have skirted the issue.

The Third Circuit adopted the Opinion of the District Court, which relied on other cases, mostly within the Northern District Court of Illinois and the Seventh Circuit. Pet. App. 7a.[6]

Further, the District Court for the Northern District of Illinois, Eastern Division, in the Matter of Lake States Commodities, Inc., 936 F. Supp. 1461 (7th Cir. 1996), declined to imply a private cause of action into Bylaw 1101 and its Interpretive Notice, due to plaintiffs' failure to offer persuasive justification for reaching a different outcome. That court relied upon the Seventh Circuit cases of Indemnified Capital Invs., S.A. v. R.J. O'Brien & Assoc., Inc., 12 F.3d 1406, 1412 (7th Cir. 1993) regarding NFA Compliance Rule 2-4 and Spicer v. Chicago Board of Options Exchange, Inc., 977 F.2d 255, 265 (7th Cir. 1992) regarding §6(b)(5) of the Securities Exchange Act of 1934 for violations of Chicago Board of Option rules. In both instances the courts refused private cause of actions against FCMs and market-makers for alleged failure to comply with association and exchange rules which govern internal operations regarding "just and equitable principles of trade."

The Court in the Matter of Lake States Commodities, Inc., supra. 1469 (7th 1996), was looking for the plaintiffs to

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[6] Neither the District Court nor the Third Circuit addressed the decision of the Southern District Court of Texas, wherein the Court refused to make a blanket statement that all violations of Exchange [NFA] rules would support a claim for private relief. Porter v. Shearson Lehman Brothers, Inc., 802 F. Supp. 41, 61 (S.D. Texas 1992).

offer a persuasive justification for a different outcome, recognizing that the plaintiffs therein were not relying on the same rules at issue in Indemnified Capital Invs., S.A. and Spicer.

NFA Bylaw 1101 is a regulatory rule to stop the commencement of fraud (much like that described in 7 U.S.C. §6b) by non-members of the NFA. Much like Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982), NFA Bylaw 1101 is a guide to stop fraud by non-members of the NFA. Therefore, violations of NFA Bylaw 1101 as an antifraud provision of the CEA should entitle Petitioners to file a private cause of action against the FCM Respondents.

Further, the CFTC welcomes private lawsuits as specifically noted in In Acampora v. Prudential Bache Securities, Inc., [1986]-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,792 (C.F.T.C. 1987), an Administrative Law Judge found that a failure to register on the part of a respondent was caused by an oversight. The Judge stated that the failure to register is a per se violation of the CEA and may render a respondent liable for damages.

The conflict among the courts and regulatory bodies - NFA and CFTC is ripe for resolution by the Supreme Court.

B. Investors Are Entitled To A Private Cause Of Action For Damages Resulting From Violations Of NFA Bylaw 1101

Private enforcement of NFA Bylaw 1101, is a matter of first impression before the Supreme Court, a true rule for the public's protection.

The case of Porter v. Shearson Lehman Brothers, Inc., 802 F. Supp. 41, 61-63 (S.D. Tex. 1992). The aforesaid case cites the seminal case of Colonial Realty Corp. v. Bache & Co., 358 F.2d 178 (2d Cir. 1966), cert. denied, 385 U.S. 817, 87 S.Ct. 40, 17 L. Ed. 2d 56 (1966), finding that, "Congress did not intend that violations of all Exchange [NFA] Rules would support a claim for private relief. It found, rather, that the quote "just and equitable" requirement (much like the case of In re Indemnified Capital Investments, S.A. v. R.J. O'Brien & Associates, Inc., supra.) was extremely broad and that Congress intended to rely upon the disciplinary function of the Exchange to vindicate such broker-dealer misconduct. The Court suggested, however, the **more specific** (emphasis added) the rule ... the more likely that the court shall infer liability. The Court in Colonial Realty Corp. v. Bache & Co., supra, noted that, " NYSE Rule 452, which outlines the method of voting stock held in a street name, might support a private cause of action because of the integral part [it played] in SEC Regulation." Id. at 182. "This emphasis on the place of the NASD Rule and the complete regulation of the securities market (emphasis added) gave rise to what has been termed the Colonial Realty substitution test." The more specific the rule and the more integral a part it plays in the total scheme of securities regulation, the more likely that the Court should infer liability. This analysis was likewise followed by the Court in Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135 (7th Cir. 1969), cert. denied, 396 U.S. 838, 90 S.Ct. 98, 24 L. Ed. 2d 88 (1969), where the Court of Appeals for the Seventh Circuit held that liability could be implied from a breach of NYSE Rule 405. The Court emphasized investor protection and the remedial purpose of NYSE Rules instead of stressing, as did Colonial Realty Corp. the place the regulation played in the total context of investor protection.

1. NFA Admits Regulatory Intent To Allow Private Right To Enforce Bylaw 1101

Notwithstanding the fact that the Buttrey Court found NYSE Rule 405 to allow for a private cause of action the NFA has specifically indicated in its "Know your customer" rule, Rule 2-30 [NYSE Rule 405 is a know your customer rule], that such shall not allow for a private cause of action specifically referencing NYSE Rule 405, for several reasons. First, a business conduct standard promulgated by a self-regulatory organization does not create a private clause of action. Second, NFA Rule 2-30 is not an anti-fraud rule." The NFA equates an industry housekeeping process to a business conduct standard. The NFA specifically places us on notice that NFA Rule 2-30 should not specifically be construed to expose members to increased potential liability for damages in litigation or administrative proceedings. Since this particular qualification does not appear in any other Interpretive Notice nor NFA bylaw and rule, one may, by process of elimination, state that there is a private cause of action against the NFA for violation by it or any of its Members of any other bylaw or rule. On the other hand, the NFA should not be allowed to protect its Members from a private cause of action in a self-regulated industry when the bylaws or rules have an inherently important place in the complete regulation of the commodities market and for the protection of the public investor.

In re Indemnified Capital Invs., S.A. v. R.J. O'Brien & Associates, Inc., 12 F.3d 1406, 1412 (7th Cir. 1993) the Court of Appeals affirmed the dismissal of a breach of fiduciary duty claim based on NFA Compliance Rule 2-4. NFA Compliance Rule 2-4, "Just And Equitable Principles Of Trade," is concerned with the conduct of the commodity futures business and that the NFA Members and Associates shall observe high standards of commercial honor and just and

equitable principles of trade in the conduct of the commodity futures business. This Rule must be deemed a business conduct standard. This is very much like NFA Rule 2-30. NFA Compliance Rule 2-30 is a "know your customer" rule; however, it does not require the Member or Associate to make the final determination that a customer should be barred from futures trading on suitability grounds. Some "know your customer" rules in the securities industry (New York Stock Exchange Rule 405, for example) have been construed in that manner; these interpretations do not apply to NFA Rule 2-30.

2. NFA Bylaw 1101 Is A Specific Rule For The Public's Protection

On the other hand, NFA Bylaw 1101 is more than a business conduct standard. NFA Bylaw 1101 is one of the Rules that are very specific and not general. The Second Circuit Court of Appeals requires a FCM to make a reasonable inquiry to determine if a third party is required to be licensed. NFA Bylaw 1101 requires Members to make two determinations: whether it is doing business with an entity requiring registration, and if so, whether that person is an NFA Member. The second of these determinations is simple. Any Member can call NFA's information center at a toll free number (1-800-621-3570) to receive current and accurate information concerning the Membership status of any person.

NFA Bylaw 1101 is more than a business conduct standard and is to be enforced with strict liability. Therefore, a per se violation has a private cause of action. The Rule does not require proof that the Member firm was at fault or failed to exercise due diligence - "simply that it transacted business with a non-member that is required to be registered." Pet. App.

147a.[7] If NFA Bylaw 1101 is not treated at a higher level than a typical business conduct standard there will be no mechanism to stop those who are not registered from trading with an FCM.[8]

The case of Cort v. Ash, 422 U.S. 66, 78, 95 S.Ct. 2080, 2088, 45 L. Ed. 2d 26 (1975) sets forth four (4) major factors to be considered when determining the existence of a private right of action under a federal statute which does not provide for one. The same four (4) factors should be viewed in determining whether or not NFA Bylaw 1101 should allow for a private cause of action. The factors are as follows:

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[7] Reference is hereby made to the Compliance Guide at Pet. App. 151a - 153a), which states that, "it was not until 1978, when Congress specifically authorized mandatory membership, that the last major obstacle to the establishment of an effective self-regulatory organization was removed. ... Simply stated, this means that persons who are not or do not remain qualified for NFA membership are prevented or barred from dealing with the public in a business that involves buying or selling futures or options contracts for commodity customers. This is because they will be unable to obtain execution of their orders."

[8] As members of the NFA, the FCM Respondents are bound by the rules of the NFA - its rules are in the nature of agreements with all its members. Equidex, Inc. v. National Futures Association, Superior Court of New Jersey, Law Division, Hudson County, Docket No. HUD-L-9424-92 (1996). Judge Margulies found that membership in the NFA constituted a "contract" that binds members to perform under the rules. The only beneficiary of this contract is the public. Yet, the courts remain ambiguous and undecided as to the public's rights under this contract. The public is a third-party beneficiary of such an agreement.

(1) Is the Plaintiff one of the class where who special benefit the statute was enacted? - Yes, to protect the investor and the national public interest.

(2) Is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? - Yes, to disallow trading with one who is not registered pursuant to 7 U.S.C. §§6d, 6e, 6k, and 6n.

(3) Is it consistent with the underlying purposes of the legislative scheme to imply such a remedy to the Plaintiff? - Yes, to disallow trading with one who is not registered pursuant to 7 U.S.C. §§6d, 6e, 6k, and 6n and for the national public interest.

(4) Is this an area traditionally relegated to state law? – No

The time is right for the Supreme Court to revisit the Cort v. Ash factors. The association rule before us is one of great import to controlling fraud for the public benefit within the commodity industry and among NFA Members and non-members. By revisiting the factors for determining the right to a private cause of action for a violation of an association rule the Supreme Court will also have the opportunity to review the statutory intent of the CEA relative to NFA Bylaw 1101 as well as the discussions concerning the approval thereof by the CFTC before applying the factors to NFA Bylaw 1101. If not, the public will not be protected and the statutory intent will continue without clarity.

C. Commodity Ponzi Schemes Flourish Under Present State of Regulatory Controls - Outcome Important To National Public

Among a remarkable number of commodity frauds and Ponzi schemes there runs an alarming common thread. In case after case, NFA members violated Bylaw 1101 and conducted business with non-member defrauders. In each instance, the public was defrauded. In each instance, NFA members were able to pocket huge sums from commissions generated from the defrauded with impunity. In each instance, the violation of NFA Bylaw 1101 is discovered substantially after the occurrence of the fraud. However, the NFA's failure to enforce Bylaw 1101 leaves the FCM Members with little fear of disciplinary action and little desire to self-regulate. It is the very circumstances under which the CFTC suggests that there should be private causes of action for enforcement of the CEA. Petitioners reflect an exact profile of numerous other investors who have been defrauded under similar circumstances.[9]

The Respondent, Saul Stone & Company LLC, in September, 1982, had received an actual notice of a "Ponzi" scheme of Fraud and Deceitful Practices similar to that in the case at bar. A complaint was filed in that matter with the

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[9] For example, Princeton Economics International Ltd./Martin Armstrong (non-members) and Republic New York Securities (NFA Member) - $500 million dollar fraud, discovered 1999; Philip Ferguson (non-member), traded member FCMs – unknown losses, fraud discovered 2000; Robert H. Rutman (non-member), fraud discovered 1997; Lake States Commodities, Inc./Thomas Collins (non-members) and Heinhold Commodities (NFA Member) - $60 million dollar fraud, commenced in 1984 and discovered in 1994.

United States District Court for the Northern District of Illinois under No. 82-C-6611. In June, 1985, Saul Stone & Company LLC once again received a notice of a similar "Ponzi Scheme" in which a complaint was filed in the United States District Court for the Eastern District of Washington under No. C-855-522-RJM. Little, if any action has been taken by the NFA against Saul Stone & Company LLC for its past and present violations of NFA Bylaw 1101.

ARGUMENT II:
NFA BYLAW 1101 IS A REQUIRED RULE PURSUANT TO THE STATUTORY INTERPRETATION OF 7 U.S.C. §21

In order for the NFA to be held liable pursuant to 7 U.S.C. §25(b)(2) (Pet. App. 179a) it must have failed to enforce a bylaw or rule required by 7 U.S.C. §21. But for NFA Bylaw 1101, the CFTC would not have granted the NFA registration as a futures association.

In enacting Section 21(m), Congress took note that:

> "This objective [of self-regulation] would be frustrated if futures industry professionals were free to discontinue their membership in the relevant association or associations when their own acts and practices came under scrutiny or investigation ... ." Pet. App. 112a.[10]

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[10] S. Rep. No. 850, 95th Cong., 2d Sess. 31 (1978).

Congress thus affirmatively rejected arguments against a mandatory approach to futures association membership. Pet. App. 112a.

As used in 7 U.S.C. §21(m) (Pet. App. 173a), MAY means SHALL and is mandatory. Much like Harvey v. Essex County Board of Freeholders, 30 N.J. 381, 393, 153 A.2d 10 (1959), "may" was determined by the New Jersey Supreme Court to mean, "shall." In determining whether a statute is mandatory or directive regard shall be had to the proposed intent of the legislature. Harvey v. Essex County Board of Freeholders, supra. 391.

The CFTC must find, and did find, that the NFA is in the public interest and that it will be able to comply with the rules and regulations of 7 U.S.C. §21 in order to carry out the purposes thereof. The intended purposes could not be carried out without the required NFA membership. The New Jersey Supreme Court in Harvey v. Essex County Board of Freeholders, supra. 32, cited to and quoted from City of Bayonne v. North Jersey, etc., Commission, 30 N.J. Super. 409, 417-419, 105 A.2d 19 (App. Div. 1954), wherein it was held, "that the word 'may' must be given a mandatory significance where it is employed in a statute to delegate a power, the exercise of which is important for the protection of public interests (emphasis added) and where it can clearly be taken from the nature and the object of the statute, a mandatory significance was intended."

On the other hand, in the extraordinary case, where a literal reading of the statutory language produces an absurd result, further inquiry is required. Moreover, a court may depart from the plain language of a statute by an extraordinary showing of a contrary congressional intent. Idahoan Fresh v. Advantage Produce, Inc., 157 F.3d 197, 202 (3d Cir. 1998).

An analysis of the statutory language and the interpretation of it by the CFTC is more specifically set forth hereinabove in the Statement Of The Case - A. Statutory Background and B. Registration of the NFA, at pages 1 through 6, supra.. It is clear that Congress desired a mandatory approach to futures association membership. Pet. App. 112a. Likewise, the CFTC determined that such membership of a registered futures association was essential to avoid abusive practices. Pet. App. 114a. The approval of NFA bylaw 1101 as part of the CFTC ORDER can only be viewed as a required rule. One must give considerable weight to the CFTC's position and interpretation of the statute it is entrusted to administer. Judicial deference to reasonable interpretations by an agency of a statute that the agency administers is a dominant, well-settled principle of federal law. The court must look at the structure and language of the statute as a whole. National Railroad Passenger Corporation v. Boston And Maine Corporation, 503 U.S. 407, 417 (1992).

Registration of the NFA would not have been approved without NFA bylaw 1101. 7 U.S.C. §21(b) states, "An applicant shall not be registered as a futures association unless the Commission [CFTC] finds, under standards established by the Commission, that -

> "(1) such association is in the public interest (emphasis added) and that it will be able to comply with the provisions of this section (§21) and the rules and regulations thereunder and to carry out the purposes of this section ..."

This Court should read the language of the statute as a whole, in particular, 7 U.S.C. §§ 21(b), (m). In so doing, the only clear interpretation is to conclude that a registered futures association rule of mandatory membership is required pursuant

to 7 U.S.C. §21(m) to carry out the intended purposes of the CEA.

ARGUMENT III:
ENFORCEMENT OF NFA BYLAW 110 SHOULD BE CONSISTENT WITH THE ADMINISTRATIVE PROCEDURES ACT

To be consistent with the Administrative Procedures Act ("APA"), there must be judicial review of the standard of criteria applicable for the enforcement of NFA Bylaw 1101 in determining if Bylaw 1101 is required under the CEA.

Further, the District Court failed to conduct any probative evaluation of the deliberate and multiple failures of the NFA to enforce Bylaw 1101 when the authority to enforce was vested directly with the very violators of this Bylaw. This severe conflict of interest rises to the level of bad faith when the motive not to act in the public's interest is self-serving and when the association has actual notice, which it deliberately ignores.[11] Although bad faith action is required to enforce

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[11] Only partial guidance is available from existing law in Sam Wong & Son, Inc. v. N.Y. Mercantile Exchange, 735 F.2d 633 (1984). Dissimilar facts cloud the issue. In Sam Wong, the court found:

> "When self-interest or other ulterior motive unrelated to proper regulatory concerns is alleged to constitute sole or dominant reason for exchange action, complaint is sufficient even though action was not beyond bounds of reason; on the other hand, if governors sincerely and rationally believe their action was in the public interest, there should

liability against the NFA, pursuant to 7 U.S.C. §25(b)(4)[12], such is not the case with regard to violations thereof by its Members. Thus, the critical question of potential and probable self-dealing by self-regulatory agency members who hold positions of authority remains unresolved. This issue is of vital public importance because it represents the very core of self-regulation integrity.

The standard criteria for determining liability against a NFA Member for violation of NFA Bylaw 1101, particularly when the NFA fails to enforce and prosecute such a violation, should be no different than that required by the APA. The Court is qualified to decide whether the NFA has abused its discretion in this case. Neither the NFA's nor the CFTC's refusal to review are unsuitable for judicial scrutiny. Unlike Heckler v. Chaney, 470 U.S. 821 (1985), yet like Cardoza v.CFTC, 768 F.2d 1542 (7th Cir. 1985), it is fair to say that in the case at bar, a complete lack of judicial scrutiny of the NFA's decisions not to review and enforce Bylaw 1101 would frustrate congressional intent. Further, like Cardoza, there are meaningfully standards found in NFA Bylaw 1101 Interpretive Notice by which to review the NFA's actions. It is well settled "that regulations validly prescribed by a government administrator are binding upon him as well as the citizen, and

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> not be liability simply because exchange action has incidental effect of advancing their private interests or damaging someone they do not like. Commodity Exchange Act §22(b)(4) as amended, 7 U.S.C. §25(b)(4)."

[12] As in Sam Wong, supra., the issue of bad faith is not raised before the Supreme Court, but is subject to remand for factual review.

that this principle holds even when the administrative action under review is discretionary in nature. Cardoza, supra. However, in this case NFA Bylaw 1101 Interpretive Notice references strict liability for a violation thereof, the factor being whether the member knew or should have known. The Supreme Court has approved judicial review for an agency abuse of discretion. Cardoza, supra. The standard set forth in the APA at 5 U.S.C. § 706(2)(A), that an agency action may be set aside if it is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with the law," is the appropriate one.

The NFA's actions should be reviewed within the standard criteria of NFA Bylaw 1101 Interpretive Notice. An investor who has been damaged from a violation of Bylaw 1101 should be entitled to pursue a private cause of action, particularly when the NFA fails to do so and it is deemed an abuse of discretion upon judicial review of the standard criteria.

In this case, the NFA refuses to enforce NFA Bylaw 1101 for the protection of the public, effectively avoiding its responsibility. Block v. S.E.C., 50 F.3d 1078 (D.C. Cr. 1995).

Agencies may find it worthwhile to give short shrift to a particular claim if the aggrieved party can file its own suit (as the futures markets may), for turning it over to private litigation frees up time without necessarily diminishing the enforcement of the statute (in this case, NFA Bylaw 1101). Board of Trade of City of Chicago v. S.E.C., 883 F.2d 525 (7th Cir. 1989).

The NFA consistently fails to enforce the required Bylaw 1101. The NFA does not maintain a consistent rule, pursuant to 7 U.S.C §21(b)(8), to appropriately discipline its

members and persons associated with its members, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules. By regularly and lightly sanctioning Saul Stone & Company LLC for violating NFA Bylaw 1101, a strict liability rule, NFA violates §21(b)(8), also a required rule.

Saul Stone & Company LLC has not been expelled after three (3) such violations. Saul Stone's ongoing failure to abide by NFA Bylaw 1101 and the NFA's failure to previously expel Saul Stone & Company LLC from its membership caused the Petitioners' losses. A finding of a "gross abuse of discretion" can be supported by proof of the suggestion that the NFA has consistently applied a different standard to the violations of "large and powerful FCMs," and thus exercised its powers discriminatorily. Hiller v. Securities And Exchange Commission, 429 F. 2d 856, 859 (2d Cir. 1970).

CONCLUSION

For the reasons set forth hereinabove, Petitioners respectfully request that the Petition for Writ of Certiorari be granted.

Respectfully submitted,

/s/_____
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APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[Filed August 7, 2000]

No. 98-5390

RICHARD NICHOLAS; LYNN NICHOLAS; ROBERT M. BLACKBURN; AND CHERYL S. BLACKBURN, ON BEHALF OF THEMSELVES AND ON BEHALF OF THE CLASS OF ALL OTHERS SIMILARLY SITUATED, *Appellants,*	)
v.	)
SAUL STONE & COMPANY LLC, F/K/A SAUL STONE AND COMPANY; FIRST OPTIONS OF CHICAGO, INC., dba LIT DIVISION OF FIRST OPTIONS; SMITH BARNEY INC; LFG, LLC, F/K/A LINNCO FUTURES GROUP, INC.; GNI INCORPORATED; DEAN WITTER REYNOLDS, INC.; ING (U.S.) SECURITIES FUTURES & OPTIONS, INC. dba ING FUTURES & OPTIONS; MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC.; PRUDENTIAL	)

SECURITIES, INC.; ROSENTHAL)
COLLINS GROUP, L.P. F/K/A)
ROSENTHAL & COMPANY; E.D. & F.)
MAN INTERNATIONAL INC., F/K/A)
E.D. & F. MAN INTERNATIONAL)
SECURITIES, INC.; CLARANCE)
DELBRIDGE, III; THOMAS H. STONE;)
NATIONAL FUTURES ASSOCIATION;)
JOHN DOE; JOAN DOE; JACK DOE;)
JOSEPH DOE; JANE DOE; JAKE DOE;)
JEFF DOE; JEAN DOE; JAMES DOE;)
JILL DOE AND JOEL DOE; GNI)
LIMITED)
)

On Appeal from the United States District Court
for the District of New Jersey
District Judge: Honorable Anne E. Thompson
D.C. No. 97-860

Argued July 15, 1999.

Before: ROTH and RENDELL, *Circuit Judges* and POLLACK,* *District Judge*

* Honorable Louis H. Pollack, United States District Judge for the Eastern District of Pennsylvania, sitting by designation.

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel on July 15, 1999.

On consideration whereof, it is now here ORDERED AND ADJUDGED by this Court that the judgment of the said District Court entered June 30, 1998, be, and the same is hereby AFFIRMED. Costs taxes against appellants. All of the above in accordance with the opinion of this Court.

ATTEST:

/s/_____
Acting Clerk

Dated: August 7, 2000

Certified as a true copy and issued in lieu
of a formal mandate on August 31, 2000

Teste: /s/_____

Clerk, United States Court
of Appeals for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

[Filed August 7, 2000]

No. 98-5390

RICHARD NICHOLAS; LYNN NICHOLAS; ROBERT M. BLACKBURN; AND CHERYL S. BLACKBURN, ON BEHALF OF THEMSELVES AND ON BEHALF OF THE CLASS OF ALL OTHERS SIMILARLY SITUATED, *Appellants,*	)
v.	)
SAUL STONE & COMPANY LLC, F/K/A SAUL STONE AND COMPANY; FIRST OPTIONS OF CHICAGO, INC., dba LIT DIVISION OF FIRST OPTIONS; SMITH BARNEY INC; LFG, LLC, F/K/A LINNCO FUTURES GROUP, INC.; GNI INCORPORATED; DEAN WITTER REYNOLDS, INC.; ING (U.S.) SECURITIES FUTURES & OPTIONS, INC. dba ING FUTURES & OPTIONS; MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC.; PRUDENTIAL SECURITIES, INC.; ROSENTHAL COLLINS GROUP, L.P. F/K/A ROSENTHAL & COMPANY; E.D. & F.	)

MAN INTERNATIONAL INC., F/K/A)
E.D. & F. MAN INTERNATIONAL)
SECURITIES, INC.; CLARANCE)
DELBRIDGE, III; THOMAS H. STONE;)
NATIONAL FUTURES ASSOCIATION;)
JOHN DOE; JOAN DOE; JACK DOE;)
JOSEPH DOE; JANE DOE; JAKE DOE;)
JEFF DOE; JEAN DOE; JAMES DOE;)
JILL DOE AND JOEL DOE; GNI)
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Argued July 15, 1999.

Before: ROTH and RENDELL, *Circuit Judges* and POLLACK,* *District Judge*

OPINION OF THE COURT

POLLAK, District Judge.

Appellants seek review of a judgment of the District Court of New Jersey granting defendants' motion to dismiss plaintiffs' amended complaint. The District Court dismissed

* Honorable Louis H. Pollak, United States District Judge for the Eastern District of Pennsylvania, sitting by designation.

the complaint for lack of personal jurisdiction over the two individual defendants, and for failure to state any claims upon which relief could be granted against the other defendants. We conclude that it was proper for the District Court to grant the motion to dismiss, and hence we will affirm.

I. Facts

We begin by summarizing the principal facts alleged in the amended complaint-- facts to be taken as true for the purpose of testing the legal sufficiency of plaintiffs' claims. According to the amended complaint, the plaintiffs (suing both on their own behalf and also, putatively, as representatives of others similarly situated[1]) are persons who, between 1989 and 1995, were lured into improvident investments in the commodities market by Chuck ("Chuckles") Kohli, Nungambukkam Swamy Ramchandran,[2] and certain corporate pawns of Kohli and Ramchandran known collectively as "Sigma."[3] Plaintiffs alleged that Kohli, Ramchandran, and Sigma held themselves out as successful

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[1] The District Court dismissed the amended complaint prior to consideration of the appropriateness of class certification. In this court, therefore, the parties are limited to the named plaintiffs and defendants, and the issue of class certification is not before us.

[2] The record is not entirely consistent with respect to the spelling of Mr. Ramchandran's name, as is discussed, *infra*, at note 15.

[3] The "Sigma" enterprises were: Sigma, Inc., Geronimo, Inc., Vol Partners, L.P., and Savid Group.

managers of various commodity pools and thus were able to raise between forty-one and sixty-eight million dollars. The investors were told that the funds would be placed in a commodities trading pool[4] and used to invest in commodities futures and options. Plaintiffs and other investors signed powers of attorney giving Kohli, Ramchandran, and Sigma discretionary authority over investing and trading decisions with respect to their investments. Plaintiffs further alleged that, although Kohli and Ramchandran did, in fact, invest the solicited funds through a variety of futures commodities merchants ("FCMs"), the bulk of those investments failed. However, in the initial phases of the allegedly fraudulent scheme, investors seeking to withdraw their funds or profits were paid with the funds of later investors, thus creating the

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[4] The Ninth Circuit, speaking through Judge Nelson, has pointed out that "[w]hile numerous courts have dealt with the concept of commodity pools in the abstract, few have specifically attempted to define what constitutes a pool." *Lopez v. Dean Witter Reynolds, Inc.*, 805 F.2d 880, 883 (9th Cir.1986). Using as its models the few relatively precise judicial descriptions of the operations of commodities pools, the Ninth Circuit drew the following profile of a pool: "(1) an investment organization in which the funds of various investors are solicited and combined into a single account for the purpose of investing in commodity futures contracts; (2) common funds used to execute transactions on behalf of the entire account; (3) participants share pro rata in accrued profits or losses from the commodity futures trading; and (4) the transactions are traded by a commodity pool operator in the name of the pool rather than in the name of any individual investor." *Id.*

aura of success. The plaintiffs' pleadings characterized this structure as a Ponzi scheme.[5]

Kohli has since pled guilty to federal criminal charges stemming out of these events, and Ramchandran has since filed for bankruptcy. As a result, plaintiffs have undertaken to seek recoupment of their losses elsewhere. Plaintiffs brought suit in the District Court for New Jersey against the FCMs used by Kohli, Ramchandran, and Sigma, as well as the National Futures Association ("NFA")--the futures industry's designated self-regulatory organization[6] --and two of the NFA's officers.

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[5] "The term 'Ponzi scheme' is derived from Charles Ponzi, a famous Boston swindler. With a capital of $150, Ponzi began to borrow money on his own promissory notes at a 50% rate of interest payable in 90 days. Ponzi collected nearly $10 million in 8 months beginning in 1919, using the funds of new investors to pay off those whose notes had come due." *United States v. Masten*, 170 F.3d 790, 797 n. 9 (7th Cir.1999) (quotations and citations omitted).

[6] The NFA is a Registered Futures Association which, pursuant to the Commodities Exchange Act § 17, 7 U.S.C. § 21, functions as the futures industry's self-regulatory organization. It performs screening to determine fitness to become and remain a member of the NFA, establishes and enforces certain rules and standards, audits and investigates members, and conducts arbitration in futures disputes. In order to engage in the business of buying or selling futures contracts for the public, one generally must be a member of the NFA.

Because of the various registration requirements (detailed below) laid down by the Commodities Exchange Act ("CEA"), 7 U.S.C. § 1a, *et seq.*, and state securities law, Kohli, Ramchandran, and Sigma were, so plaintiffs alleged, under a duty to register with the Commodities Futures Trading Commission (the "CFTC"), the Securities and Exchange Commission, and the New Jersey Bureau of Securities; they were also, plaintiffs alleged, obligated to become members of the NFA. Plaintiffs further alleged that Kohli, Ramchandran, and Sigma, in fact, did not register with the several regulatory agencies, or become members of the NFA, and hence that the various FCMs that accepted their business acted improperly. In particular, plaintiffs alleged that the defendant FCMs and their employees failed to inquire into the source of funds in the Sigma accounts or into the CFTC registration status and NFA membership of Kohli, Ramchandran, and Sigma. Plaintiffs contended that had the defendants made such an investigation, they would have discovered that Kohli, Ramchandran, and Sigma were trading in violation both of the registration requirements of the CEA--which mandate that any person associated with a commodity pool operator be registered with the CFTC[7] --and of the

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[7] The CEA provides that: "[i]t shall be unlawful for any person to be associated with a commodity pool operator as a partner, officer, employee, consultant, or agent (or any person occupying a similar status or performing similar functions), in any capacity that involves (i) the solicitation of funds, securities, or property for a participation in a commodity pool or (ii) the supervision of any person or persons so engaged, unless such person is registered with the Commission under this chapter as an associated person of such commodity pool operator and such registration shall not have expired, been suspended (and the period

membership requirements of the NFA.[8] Plaintiffs alleged that the FCMs and their employees, by failing to make the necessary investigation, directly violated the CEA, and aided and abetted violations of the CEA;[9] breached certain contracts with the NFA of which appellants were third-party beneficiaries; violated New Jersey's Uniform Securities Law, N.J.S.A. 49:3- 47, *et seq.*; breached fiduciary duties owed to appellants; acted negligently; violated provisions of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961, *et seq.*; committed fraud; engaged in civil conspiracy; and, lastly, violated New Jersey's Consumer Fraud Act, N.J.S.A. 56:8-1, et seq. Thus, of the nine claims asserted against the defendant FCMs, all but three--namely the alleged violations of the CEA (both direct and aiding-and-abetting) and of RICO--sound in state law.

- of suspension has not expired), or been revoked." 7 U.S.C. § 6k(2).

[8] *E.g.*, NFA By-law 1101 provides that "[n]o Member may carry an account or accept an order or handle a transaction in commodities futures contracts for or on behalf of any non-Member of the NFA, or suspended Member, that is required to be registered with the [CFTC] as an FCM, Introducing Broker, Commodity Pool Operator, Commodity Trading Advisor, or Leveraged Transaction Merchant, and that is acting in respect to an account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or other person."

[9] Subsection 22(a)(1) of the CEA, 7 U.S.C. § 25(a)(1), is discussed *infra*, at note 12 and accompanying text.

In addition to alleging that the defendant FCMs failed to conduct inquiries into the source of the funds of Kohli, Ramchandran, and Sigma, plaintiffs claimed that the NFA, as well as two of its officers--individual defendants Thomas Stone and Clarence Delbridge III--were instrumental in enabling Kohli, Ramchandran, and Sigma to operate the alleged Ponzi scheme. As noted above, the NFA is the futures industry's self-regulatory organization. Persons and corporations trading in commodities futures and options are, for practical purposes, required to be members of the NFA, as NFA by-laws preclude members from handling transactions for persons who are required to be registered with the CFTC but are not members of the NFA.[10] Plaintiffs alleged that the NFA, and Stone and Delbridge, acting in bad faith, failed to enforce the rules and by-laws of the NFA prohibiting the FCMs from trading with Kohli, Ramchandran, and Sigma. This bad faith failure, so plaintiffs contended, made Stone, Delbridge, and the NFA civilly liable under subsection 22(b)(2) of the CEA, 7 U.S.C. § 25(b)(2).[11] This is the sole

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[10] *See supra* note 8.

[11] Subsection 22(b)(2) of the CEA provides, in pertinent part:

> (2) A registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title or in enforcing any such bylaw or rule violates this chapter or any Commission rule, regulation, or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce

federal claim asserted against defendants Stone and Delbridge

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> or enforcement of such bylaw or rule.
>
> (3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a contract market, clearing organization, licensed board of trade, or a registered futures association willfully aids, abets, counsels, induces, or procures any failure by any such entity to enforce (or any violation of the chapter in enforcing) any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, shall be liable for actual damages sustained by a person who engaged in any transaction specified in subsection (a) of this section on, or subject to the rules of, such contract market, licensed board of trade or, in the case of an officer, director, governor, committee member, or employee of a registered futures association, any transaction specified in subsection (a) of this section, in either case to the extent of such person's actual losses that resulted from such transaction and were caused by such failure or violation.
>
> (4) A person seeking to enforce liability under this section must establish that the contract market, licensed board of trade, clearing organization, registered futures association, officer, director, governor, committee member, or employee acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss.

7 U.S.C. § 25(b)(2).

and the NFA.

Plaintiffs further contended that the NFA by-laws and rules prohibiting the FCMs from trading with Kohli, Ramchandran, and Sigma created contractual obligations, and that plaintiffs, as third-party beneficiaries of those contracts, were entitled, under New Jersey law, to sue the NFA, Stone, and Delbridge. Finally, plaintiffs asserted that the NFA, as well as its officers Stone and Delbridge, had, pursuant to New Jersey law, a fiduciary obligation to plaintiffs, as potential investors, to ensure that the FCMs did not trade with non-members, and that the failure to do so constituted a breach of that fiduciary duty.

Upon defendants' motion to dismiss the complaint, the District Court found that it lacked personal jurisdiction over defendants Stone and Delbridge and that, as to the other defendants, the amended complaint failed to state any claims--whether arising under federal law or state law--upon which relief could be granted. Accordingly, the District Court granted defendants' motion. *See Nicholas v. Stone*, No. 97-860 slip op. at 52 (D.N.J. June 30, 1998).

On appeal, plaintiffs--appellants in this court--argue that the District Court had valid *in personam* jurisdiction over defendants Stone and Delbridge, and that the amended complaint does state claims upon which relief could be granted.

II. Discussion

Appellants have raised numerous issues. Most do not, in our view, require discussion in this opinion because they

have been fully and correctly canvassed in the District Court's comprehensive opinion. There are, however, a few issues arising under section 22 of the CEA, 7 U.S.C.§ 25, which, we think, call for additional analysis. We agree with the District Court's disposition of those issues, but, as will be seen, as to certain aspects of those issues we proceed by a somewhat different route.

A. In personam *jurisdiction*

The District Court commenced its legal discussion by examining whether it had *in personam* jurisdiction over the two individual defendants, Stone and Delbridge, both of whom were domiciled and employed in Illinois. It will be recalled that Stone and Delbridge were (together with the NFA) sued on state law claims of breach of contract and breach of fiduciary duty and also, pursuant to subsection 22(b)(2) of the CEA, 7 U.S.C. § 25(b)(2), on a federal law claim of bad faith failure to enforce NFA rules and by-laws.

The District Court began its analysis by considering whether, as a court sitting in New Jersey, it had jurisdiction over Stone and Delbridge pursuant to New Jersey's long-arm statute which, as the District Court put it, "allows a [New Jersey state] court to exercise personal jurisdiction over non-resident defendants to the fullest extent permitted by the Due Process Clause of the Fourteenth Amendment to the United States Constitution." First, the District Court observed that "jurisdiction over the defendants does not exist simply because they are agents or employees of organizations which presumably are amenable to jurisdiction in this Court." To establish this point, the District Court aptly cited *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770, 781, 104 S.Ct. 1473,

79 L.Ed.2d 790 (1984). In *Keeton*, the Supreme Court noted that "jurisdiction over an employee does not automatically follow from jurisdiction over the corporation which employs him. . . . Each defendant's contacts with the forum state must be assessed individually." *Id.* at 781 n. 13, 104 S.Ct. 1473. Accordingly, the District Court then "assessed individually" the contacts of Stone and Delbridge with New Jersey:

> In the instant case, plaintiffs have not alleged any contact defendants Delbridge and Stone had with the forum New Jersey. Defendants Delbridge and Stone did not reside in New Jersey, did not visit here, did not own property here or even have any personal contact with the forum state. This Court cannot, therefore, find that defendants have systematic and continuous contacts with New Jersey. Further, defendants Delbridge and Stone never communicated with plaintiffs in New Jersey and never spoke or corresponded with anyone purporting to represent the Sigma entities. Therefore, this court cannot find that defendants Delbridge and Stone took any action by which they purposefully availed themselves of the privilege of conducting activities within the forum state or that would justify haling them into Court in this state. Considering this lack of any allegation that defendants had the requisite minimum contacts in their individual capacities, this Court cannot find that either specific or general jurisdiction exists over them.

The District Court's findings, amply supported by the record, establish that Stone and Delbridge could not, consistently with Fourteenth Amendment due process standards, be subjected to the *in personam* jurisdiction of the District Court with respect to a state law claim. It remains to consider whether the District Court was correct in concluding that Stone and Delbridge were also not amenable to in personam jurisdiction with respect to the federal claim appellants asserted against Stone, Delbridge and the NFA pursuant to subsection 22(b)(2) of the CEA, 7 U.S.C. § 25(b)(2).

Appellants contended in the District Court, and repeat the contention here, that Congress has authorized nationwide jurisdiction for suits arising under section 22. In support of this contention appellants have relied on subsection 22(c) of the CEA, 7 U.S.C. § 25(c). Subsection 22(c) provides as follows:

> (c) **Jurisdiction; statute of limitations; venue; process**
>
> The United States district courts shall have exclusive jurisdiction of actions brought under this section. Any such action shall be brought not later than two years after the date the cause of action arises. Any action brought under subsection (a) of this section may be brought in any judicial district wherein the defendant is found, resides, or transacts business, or in the judicial district wherein any act or transaction constituting the violation occurs. Process in such action may be served

> in any judicial district of which the defendant is an inhabitant or wherever the defendant may be found.

Appellants have argued that Stone and Delbridge are subject to the *in personam* jurisdiction of a federal district court sitting in New Jersey because the third sentence of the quoted subsection expressly provides that an "action . . . may be brought . . . in the judicial district wherein any act or transaction constituting the violation occurs." The District Court rejected the argument: "the above-stated provision is a venue provision, not a jurisdictional one, and as such, does not provide this Court with personal jurisdiction over the individual defendants." We think the District Court was right in construing the third sentence of subsection (c) as directed to venue rather than to *in personam* jurisdiction.

There is a further reason why the third sentence of subsection (c) is of no assistance to appellants. The sentence, by its own terms, addresses actions "brought under subsection (a) of this section [section 22]." Appellants' claim against Stone, Delbridge and the NFA was brought under subsection (b) of section 22.

Finally, appellants invoke the fourth sentence--the concluding sentence--of subsection (c), which provides that "[p]rocess in such action may be served in any judicial district of which the defendant is an inhabitant or wherever the defendant may be found." Here again, however, the syntax of the provision is not spacious enough to accommodate appellants' argument. The phrase "such action" in the fourth sentence of subsection (c) refers back to the immediately preceding sentence--the third sentence--which, as we have

seen, is confined to "[a]ny action brought under subsection (a)." This textual understanding is confirmed by the Senate Report on the Futures Trading Practices Act of 1992, which states, *inter alia*, that the Act "amends [sub]section 22(c) of the Commodities Exchange Act to authorize nationwide service of process in . . . private actions brought under [sub]section 22(a) of the Act," S.Rep. No. 102-22, at 58, *reprinted in* 1992 U.S.C.C.A.N. 3103, 3160.

In sum, the District Court was correct in ruling that, with respect to (a) appellants' state law claims against Stone and Delbridge, and (b) appellants' federal law claim against these two individual defendants, *in personam* jurisdiction was lacking.

B. Liability under Section 22 of the CEA

The District Court dismissed all three federal claims against the defendant FCMs. On appeal, plaintiffs have chosen not to press their claims arising under RICO, thereby limiting themselves to arguing for the revival of the remaining two federal claims, namely, that the FCMs (1) directly violated, and (2) aided and abetted in the violation of, the CEA.

Subsection 22(a)(1) of the CEA, 7 U.S.C. § 25(a)(1),[12] creates a private right of action for "actual

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[12] Subsection 22(a)(1) provides, in full:

> Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter

or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person–

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of--

(i) an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a

damages" caused by "[a]ny person . . . who violates this chapter [the CEA] or who willfully aids [or] abets . . . the commission of a violation of this chapter."

i. Liability for direct *violation of the CEA*

A plaintiff may bring a private damage action against "[a]ny person who violates" the CEA when that person stands in one of four relationships with the plaintiff specified in subparagraphs (A) through (D) of subsection 22(a)(1). *See* 7 U.S.C. § 25(a)(1)(A)-(D). Each of the required relationships involves the "person" sued having given advice related to the sale of commodities, or having participated in a transaction related to such sales. Subparagraph (A) imposes liability on the "person" sued when a plaintiff "received trading advice from such person for a fee"; subparagraph (B) imposes liability on the "person" sued when the plaintiff "made through such person" a contract for futures or options thereon, or when the plaintiff deposited money or other property with "such person" in connection with a futures or options contract; subparagraph (C) imposes liability on the "person" sued when the plaintiff purchased from or sold to "such person," or placed through "such person" an order for, certain specified options or commodities contracts, or "an interest or participation in a commodity pool"; and subparagraph (D) imposes liability on the "person" sued when the plaintiff "purchased or sold a contract referred to in

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> manipulation of the price of any such contract or the price of the commodity underlying such contract.

7 U.S.C. § 25(a)(1).

subparagraph (B) if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract." (Emphasis added). If the "person" sued has participated in one of the transactions specified in these four subparagraphs, then "such person" can be held liable "for actual damages resulting from one or more of the [specified] transactions . . . and caused by such violation" to the plaintiff. Thus, in order for a plaintiff to sue a defendant for directly violating subsection 22(a)(1), the defendant must (1) have violated the CEA, and (2) stand in an appropriate relationship to the plaintiff with respect to the violative conduct.

Appellants, in their amended complaint, alleged that the FCMs were liable under subsection 22(a)(1) to plaintiffs because of their participation in transactions described in subparagraphs (A), (B), and (C). In particular, appellants alleged that the defendant FCMs gave trading advice to Kohli, who was, so appellants alleged, in some sense, appellants' agent. Similarly, appellants alleged that the FCMs accepted orders of the kind described in subparagraph (B) from Kohli. And finally, appellants contended that the FCMs fell under subparagraph (C) insofar as they permitted Kohli, Ramchandran, and Sigma to sell to appellants interests in commodity pools in violation of the CEA.

Appellants do not contend that the defendant FCMs themselves stood in one of the listed relationships to one or more of the appellants. Instead, appellants argue that the FCMs were directly liable by virtue of a relationship between the FCMs and an agent of the appellants. According to appellants, the conclusion that "Defendant FCMs were dealing directly with Plaintiffs for purposes of violating 7 U.S.C.

§ 25(a)(1)(A)-(D)" follows from the fact that "Kohli, the acknowledged primary violator was the Plaintiff's [sic] agent." The District Court rejected appellants' theory, stating that "[p]laintiffs have provided no authority for allowing a [subsection 22(a)(1)] relationship to be established through an agency theory and there is no indication in the statute indicating the availability of such relief." *Nicholas v. Stone*, slip op. at 24. Without deciding whether or to what extent an agency relationship can ever appropriately be used to establish a subsection 22(a)(1) relationship, we agree with the District Court that the agency theory invoked by appellants does not fit this case. For, as the District Court stated, "allowing such a theory in the instant case, where Kohli, although technically the agent of the plaintiff[s], was clearly not operating in plaintiffs' interests does not seem appropriate." *Id.* Accordingly, the FCMs' transactions with Kohli (and/or Ramchandran and/or Sigma) do not suffice to make them liable to appellants under subsection 22(a)(1).[13]

We turn, then, to appellants' alternate subsection 22(a)(1) theory--namely that the defendant FCMs can be found liable to appellants by virtue of having "aided and abetted" Kohli (and/or Ramchandran and/or Sigma) in violating the CEA.

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[13] Under traditional concepts of agency law, it is the wrong-doing agent of the principal/merchant, not the wrong-doing agent of the victim/investor, who creates liability for the principal. Such is clearly not the case before us. For that reason, we will not comment on a situation in which the wrong-doer is the agent of the merchant rather than of the investor.

ii. Liability for aiding and abetting *violation of the CEA.*

The District Court held that the FCMs could not be liable under subsection 22(a)(1) as aiders and abetters based on its view that, in order to establish aider-and-abetter liability, a defendant must be in one of the four subparagraph-(A)-through-(D) relationships with a plaintiff. *See Nicholas v. Stone*, slip op. at 26-27. The District Court, following its previous decision in *Manley v. Stark & Stark*, Civ. No. 97-524 (D.N.J.), reached this conclusion on the basis of language in subsection 22(a)(1) which appears to treat direct and aider-and-abetter liability in parallel terms. Thus, for example, subsection 22(a)(1) provides, "Any person who violates this chapter or who willfully aids [and] abets . . . the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the [specified] transactions . . . and caused by such violation to any other person-- (A) who received trading advice from such person for a fee." 7 U.S.C. § 25(a)(1) (emphasis added). Each of the specified transactions in subparagraphs (A), (B), and (C) (the three subparagraphs invoked in the amended complaint) involves activity by "such person"--the antecedent of which appears to be a "person who violates this chapter or who willfully aids [and] abets . . . the commission of a violation."[14]

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[14] Although subparagraph (D) does not expressly refer to "such person," its operative focus is on transactions involving "a contract referred to in subparagraph (B)." We need not, however, address the ingredients of aider-and-abetter liability under subparagraph (D), since as the District Court noted, the amended complaint focused on transactions allegedly falling within subparagraphs (A), (B), and (C).

Accordingly, the syntactic structure of the statute seems to contemplate that "any person" who aids and abets can only be held liable if he is also "such person," *i.e.*, a person who performs one of the acts enumerated in (A), (B), and (C). Under this reading of the statute, it would appear that--just as with direct violators of the CEA--a plaintiff can bring private causes of action against aiders and abetters only if they (1) aid and abet a violation of the CEA; *and* (2) themselves stand in one of the relationships specified in subparagraphs (A), (B), and (C).

The District Court noted that its reading of the statute was consistent with that of the majority of district courts that had discussed the issue of the scope of aiding and abetting liability under subsection 22(a)(1) of the CEA. *See, e.g., In re Lake States Commodities, Inc.*, 936 F.Supp. 1461, 1467 (N.D.Ill.1996) ("[U]nder the plain language of these provisions, a plaintiff must demonstrate that a defendant is one of the 'such persons' listed in § 22(a)(1)(A)(D) in order to hold that defendant liable under the CEA."); *Damato v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 878 F.Supp. 1156, 1161 (N.D.Ill.1995) ("[B]ased upon the plain language of the statute, the court finds that the only persons subject to a private right of action under § 22(a)(1)(C)(ii) of the CEA are the persons who sold or took orders for interests in the commodity pool."); *Davis v. Coopers & Lybrand*, 787 F.Supp. 787, 794 (N.D.Ill.1992) ("By its literal and plain language, the 'such person' specification in CEA § 22(A)(1)(C) limits the statutory remedy to obtaining damages from the persons who sold or took orders for interests in the commodity pool.").

In holding that only "such persons" can be liable as aiders and abetters under subsection 22(a)(1) of the CEA, the District Court expressly rejected the position of the Commodities Futures Trading Commission ("CFTC"), as expressed in an *amicus curiae* brief, which had been filed by the CFTC in the then-pending appeal to the Seventh Circuit in *Damato v. Hermanson* (an appeal from the district court decision in *Damato v. Merrill Lynch, Pierce, Fenner & Smith*, cited *supra*), and which had been presented to the District Court in the present case by plaintiffs. The CFTC, in that brief, had argued that the reading adopted by the district court in *Damato* would unnecessarily limit aider and abetter liability:

> Indeed, requiring that the aider and abettor be "such person" within the meaning of subparagraphs (A) through (D) renders § 22(a) internally inconsistent and does violence to the clear intent of § 22. As indicated above, § 22(a)(1)(A)-(D) defines the persons who are appropriate plaintiffs under the CEA. It also sets forth the damages that may be recovered in a private right of action. It limits recovery to damages caused by the violation and "resulting from one or more of the transactions referred to in subparagraphs (A) through (D)." If "such person" under subparagraphs (A) through (D) referred to the aider and abettor (*i.e.*, if the aider and abettor were required to have the direct relationship with plaintiff), then the only damages recoverable would be those resulting from the transaction between the aider and abettor and the plaintiff. This is

> nonsensical, because the plaintiff's damages result not from the act of the aider and abettor in providing trading advice or selling futures, options or pool interests to the plaintiff, but from the violation itself by the primary violator. . . . Thus, for the language of § 22 to make sense, "such person" in subparagraphs (A) through (D) must refer to the primary violator and not the aider and abettor.

App. at 294-95 (reprinting the *amicus* brief of the CFTC).

Thus, according to the CFTC, "§ 22(a) creates liability for an aider and abettor if (i) he or she assists in a violation of the Act, (ii) the plaintiffs' damages are caused by that underlying violation and (iii) the damages result from one of the transactions set forth in subparagraphs (A)- (D). There is no independent requirement that *both* the primary violator and the aider and abettor deal directly with the plaintiff." *Id.*

After the District Court handed down its order dismissing the amended complaint, but prior to our consideration of this case, the Seventh Circuit handed down its decision in *Damato*. That court rejected the so-called "plain-language" interpretation because it "effectively reads out of the text Congress' specific reference to aiders and abettors in 22." *Damato v. Hermanson*, 153 F.3d 464, 470 (7th Cir.1998). Instead, stating that "[b]y definition, an aider and abettor knowingly contributes to the principal's violation rather than committing an independent violation of its own," the Seventh Circuit adopted the CFTC interpretation of subsection 22(a)(1). *Id.*

In the instant case, appellants urge this court to follow the Seventh Circuit's adoption, in *Damato*, of the CFTC approach to subsection 22(a)(1)'s aiding and abetting language. By contrast, appellees argue, contra *Damato*, that this court should look to the plain language of subsection 22(a)(1), and that--because the FCMs and their employees took no action described in subparagraphs 22(a)(1)(A) through (C)--the FCMs should not be liable as aiders and abetters. We find it unnecessary, however, to resolve this issue at this juncture. For even assuming that we were to follow *Damato*'s adoption of the CFTC approach, the defendant FCMs could, in any event, only be held liable if their conduct met the basic requirements of aiding and abetting. But plaintiffs, in their amended complaint, have not alleged such conduct.

The *Damato* court analyzed the elements of aider and abetter liability under subsection 22(a)(1) as being identical with those contemplated by the federal criminal aider and abetter statute, 18 U.S.C. § 2. *See* 153 F.3d at 473. It therefore concluded that "in order to state . . . a claim against [a defendant] . . . plaintiffs must allege that [the defendant] (1) had knowledge of the principal's . . . intent to commit a violation of the Act; (2) had the intent to further that violation; and (3) committed some act in furtherance of the principal's objective." *Id.* The Seventh Circuit thus recognized that to be an aider and abettor one must (a) have knowledge of the principal's intended violation of the statute, and (b) have the intent to promote that principal's violation. This interpretation is consistent with both the traditional understanding of what is meant by "aiding and abetting" and with the language of subsection 22(a)(1), which contemplates liability for one "who *willfully* aids [and] abets . . . the

commission of a violation" of the CEA. (Emphasis added). We agree with the Seventh Circuit that aiding and abetting in the context of the CEA is congruent with aiding and abetting as defined by 18 U.S.C. § 2. Plaintiffs, however, have not alleged that the defendant FCMs had the required knowledge and guilty intent. Thus, their allegations fall short of stating a claim that defendants aided and abetting in violations of the CEA, regardless of whether such a claim requires allegations that defendants engaged in activity described in subparagraphs (A) through (C) of subsection 22(a)(1).

The principal thrust of the allegations in the amended complaint is that the FCMs did not adequately supervise Kohli, Ramchandran, and Sigma. *See, e.g.*, Amended Complaint, ¶ 104 ("Had the FCMs diligently supervised the activities of . . . Kohli, Chandran[15] and the Sigma Entities, or made any reasonable investigation of the practices of Kohli, Chandran and the Sigma Entities, the FCMs would have discovered Kohli's, Chandran's and the Sigma Entities' fraudulent investment scheme and the material misrepresentations and omissions."). The closest that the amended complaint comes to alleging that the FCMs knew of the misconduct of Kohli, Ramchandran, and Sigma are the statements that the FCMs "were aware, or with required

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[15] "Chandran" and "Ramchandran" are names for the same person. In their amended complaint, appellants used the name "Chandran" to refer to the person called "Ramchandran" in the District Court's opinion. We have followed the District Court, thereby creating a discrepancy between the name we have generally used and the name appearing in quotations from the amended complaint.

minimal due diligence would have discovered" that "Kohli, Chandran and the Sigma Entities were a fiction under the CEA," *id.* at ¶ 128, and that the FCMs "knew or recklessly disregarded facts showing that" Kohli, Ramchandran, and the Sigma Entities were engaged in various activities violative of the CEA. Id. at ¶ 133. In essence, appellants have alleged, at most, that the FCMs acted recklessly, and that they knew or should have known of the violations by Kohli, Ramchandran, and Sigma of the CEA. But these allegations are a far cry from an allegation that the FCMs not only had knowledge of the intent of Kohli and the others to violate the CEA, but, as the Seventh Circuit put it in *Damato*, "the intent to further that violation." 153 F.3d at 473. Accordingly, even if we were to assume *arguendo* the correctness of the CFTC construction of subsection 22(a)(1)--namely, that "for the language of § 22 to make sense, 'such person' in subparagraphs (A) through (D) must refer to the primary violator and not the aider and abettor"--which was adopted by the Seventh Circuit in *Damato*, plaintiffs' amended complaint nonetheless falls short. Therefore, we conclude that the District Court acted properly in dismissing appellants' aiding and abetting claims.

C. Remaining Claims

In addition to the issues discussed above, appellants urge this court to reverse the District Court's determination that each of their state law claims against the FCMs should be dismissed as well. The claims include breach of contract, breach of fiduciary duty, negligence, fraud and civil conspiracy, violation of the New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1, *et seq.*, and violation of the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47, *et seq.*

Additionally, appellants contest the District Court's dismissal of plaintiffs' claims against the NFA. We find the District Court's discussion of these issues to be cogent and persuasive, and therefore adopt the conclusions reached by the District Court with respect to each of these issues.

III. Conclusion

For the foregoing reasons, we will affirm the judgment of the District Court.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

APPENDIX B

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

[Filed June 30, 1998]

No. 97-860(AET)

RICHARD NICHOLAS, LYNN NICHOLAS, ROBERT M. BLACKBURN, CHERYL S. BLACKBURN, On Behalf of Themselves and On Behalf of the Class of All Others Similarly Situated, *Plaintiffs,*	)
v.	)
SAUL STONE & COMPANY LLC F/K/A SAUL STONE AND COMPANY, et. al, *Defendants.*	)

ORDER

THOMPSON, Chief Judge

For the reasons stated in this Court's Opinion filed even date herewith;

It is on this 30th day of June, 1998;

ORDERED that the motion of defendants' Delbridge and Stone to dismiss pursuant to Fed. R. Civ. P. 12(b)(2) be and hereby is GRANTED; and it is further,

ORDERED that the motion of defendants GNI Incorporated and GNI Limited to dismiss be and hereby is DENIED AS MOOT; and it is further,

ORDERED that the remaining motions made by defendants to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) be and hereby are GRANTED; and it is further,

ORDERED that defendants' motion for the imposition of sanctions pursuant to Fed. R. Civ. P. 11 be and hereby is DENIED; and it is further,

ORDERED that this case is CLOSED.

/s/_____
ANNE E. THOMPSON, CHIEF JUDGE

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

[Filed June 30, 1998]

No. 97-860(AET)

RICHARD NICHOLAS, LYNN NICHOLAS, ROBERT M. BLACKBURN, CHERYL S. BLACKBURN, On Behalf of Themselves and On Behalf of the Class of All Others Similarly Situated, *Plaintiffs,*	)
v.	)
SAUL STONE & COMPANY LLC F/K/A SAUL STONE AND COMPANY, et. al, *Defendants.*	)

OPINION

THOMPSON, Chief Judge

This matter comes before the Court on the motions of various defendants to dismiss plaintiffs' complaint pursuant to Fed. R. Civ. P. 12(b)(2) and 12(b)(6) as well as defendants' motion for sanctions pursuant to Fed. R. Civ. P. 11. This

matter was decided after oral argument held on June 9, 1998. For the reasons stated below, plaintiffs' complaint will be dismissed in its entirety and defendants's motion for sanctions will be denied.

BACKGROUND

1. The Parties

The instant action was commenced by certain investors against the named defendants, most of whom are Futures Commission Merchants or broker-dealers with which the Sigma Entities conducted transactions between February of 1991 and April of 1995. The named defendants in the complaint consist of 11 distinct Futures Commission Merchants ("the "FCMs"), the National Futures Association ("NFA") and two individuals who are officers of one of the FCMs and also hold unsalaried positions on certain NFA committees. In addition, plaintiffs seek to assert claims against various unnamed employees of the FCMs. ("FCM EMPLOYEES").

Plaintiffs in this case are a number of individuals who invested money in the "Ponzi" scheme of "Chuckles" Kohli and the Sigma Entities and lost some or all of the funds they invested due to the fraud of the Sigma principals. Plaintiffs are contending that the actions or inactions of defendants in this case are actionable and expose them to liability as well.

The majority of the defendants in this case are Futures Commission Merchants, institutional clearing firms which open and clear customer accounts and hold customer funds

within the commodities industry. Defendant Saul Stone was an Illinois corporation and is now an Illinois limited liability company registered with the Commodity Futures Trading Commission under Section 4f of the CEA as a Futures Commission Merchant. Defendant Saul Stone is engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts and is a clearing member of the Chicago Mercantile Exchange as well as a member of the National Futures Association. Also named as a defendant is John Doe, an individual alleged to be an employee or agent of defendant Saul Stone who acted under the titles of "account executive," "registered representative," "associated person," "Commission broker," and "introducing broker" for Saul Stone and was acting within the actual or apparent scope of his employment or agency.

Defendant First Option was a Delaware corporation registered with the CFTC under Section 4f of the CEA engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant First Options is a clearing member of the Chicago Mercantile Exchange as well as a member of the National Futures Association. Also named as a defendant is Joan Doe, an individual employed by or an agent of defendant acting within the scope of her employment or agency.

Defendant Smith Barney was a Delaware corporation engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Smith Barney is a clearing member of the Chicago Board of Trade and the National Futures Association. Also named as a defendant is Smith Barney's employee and/or agent Joseph Doe acting within the scope of his employment or agency.

Defendant Linnco was an Illinois corporation and is now an Illinois limited liability company engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Linnco is a clearing member of the Chicago Mercantile Exchange as well as a member of the National Futures Association. Also named as a defendant is Linnco's employee and/or agent Jane Doe.

Defendant GNI, Incorporated was an Illinois corporation registered with the CFTC under Section 4f and engaged in the business of brokerage in connection with the sale of commodities and commodity futures. GNI is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Defendant GNI Limited was a foreign broker within the meaning of 17 CFR Sections 15 through 17, engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Plaintiffs contend that GNI Incorporated and GNI Limited are part of a group or family of companies that hold themselves out to the public and operate under the designation of GNI for all purposes. Also named as a defendant is GNI's employee and/or agent "Jack Doe".

Defendant Dean Witter was a Delaware corporation registered with the CFTC under Section 4f of the CEA as a FCM and is engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Dean Witter is a clearing member of the Chicago Mercantile Exchange as well as a member of the NFA. Also named as a defendant is Jeff Doe, an employee and/or agent of defendant Dean Witter.

Defendant ING was an Illinois corporation registered with the CFTC under Section 4f of the CEA as a FCM and is engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant ING is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Also named as a defendant is Jean Doe, an employee and/or agent of defendant ING.

Defendant Merrill was a Delaware corporation registered with the CFTC under Section 4f of the CEA engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Merrill is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Also named as a defendant is James Doe, an employee and/or agent of Merrill.

Defendant Prudential was a Delaware corporation registered with the CFTC under Section 4f of the CEA and engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Prudential is a clearing member of the Chicago Board of Trade as well as a member of the NFA. Also named as a defendant is Jill Doe, an employee and/or agent of defendant Prudential. ¶ 25.

Defendant Rosenthal was an Illinois corporation and is now an Illinois limited partnership registered with the CFTC under Section 4f of the CEA and engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant Rosenthal is a clearing member of the Chicago Mercantile Exchange as well as a member of the NFA. Also named as

a defendant is Jill Doe, an employee and/or agent of defendant Rosenthal. ¶ 27.

Defendant E D & F was a Delaware corporation registered with the CFTC under Section 4f and engaged in the business of brokerage in connection with the sale of commodities and commodity futures contracts. Defendant E D & F is a clearing member of the Chicago Mercantile Exchange as well as a member of the NFA. Also named as a defendant in this action is Joel Doe, an employee and/or agent of defendant E D & F. ¶ 29.

Defendants Saul Stone, First Options, Smith Barney, Linnco, GNI Incorporated, Dean Witter, ING, Merrill, Prudential, Rosenthal and E D & F are all registered with the CFTC as a FCM and are referred to collectively as "FCMs". Defendants John Doe, Joan Doe, Jack Doe, Joseph Doe, Jane Doe, Jake does Jeff Ode, Jean Doe, James Doe, Jill Doe, and Joel Doe each of whom are employees or his or her respective defendant FCMs are collectively referred to as FCM EMPLOYEES.

Defendant the National Futures Association is a Delaware corporation which is a Registered Futures Association pursuant to 7 U.S.C. § 17 of the CEA that transacts business as the future's industry's self-regulatory organization. It was established in 1976 to become the futures industry's self-regulatory organization under 7 U.S.C. § 21. As a self-regulatory organization, the NFA performs screening to determine fitness to become or remain an NFA Member, establishes and enforces rules and standards, audits and investigates members and conducts arbitration of futures related disputes. No person or firm may engage in any

business which involves buying or selling futures contracts for the public without being an NFA member. ¶ 34. Plaintiffs in this case are seeking to recover from defendant NFA alleging that the NFA breached contractual (Count Two) and fiduciary (Count VII) duties which it owed to these plaintiffs and that the NFA "acted in bad faith in failing to enforce its own Bylaws and Rules as set forth in the NFA manual pursuant to 7 U.S.C. § 21(b)(8). (Count III)

Also named as defendants in this action are Clarence Delbridge and Thomas Stone. Defendant Clarence Delbridge, a principal of Saul Stone, is a member of the NFA as an associated person and an elected member of the Regional Business Conduct Committees of the NFA for the Central Region. ¶ 32. Defendant Thomas Stone was employed as Chairman of the Board of Saul Stone, is a member of the NFA as a Floor Broker and serves as an elected member of the Advisory Committee of the NFA for Futures Commission Merchants. ¶ 33. Plaintiffs contend that in their positions, Delbridge and Stone acted as agents for both Saul Stone and the NFA.

Mr. Stone is Chairman of the Board of Saul Stone & Co. He has been employed by Saul Stone for thirty two years and has worked out of Saul Stone's offices at 30 South Wacker Drive, Chicago, Illinois since 1982. He has been a domiciliary of Illinois and has lived in Illinois for at least thirty one years.

Mr. Delbridge is an Executive Vice-President of Saul Stone & Co. He has been employed by Saul Stone since 1987 and has worked out of Saul Stone's offices at 30 South Wacker Drive in Chicago, Illinois during his employment.

Mr. Delbridge has been a domiciliary of Illinois since at least 1987. From February 1988 until March 15, 1995, Mr. Delbridge was a member of the NFA's Business Conduct Committee for the Central Region which was comprised of the following states: Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Michigan, Mississippi, Ohio, Tennessee, Texas and Wisconsin. The NFA Business Conduct Committee for the Cental Region reviewed disciplinary actions brought to their attention by NFA staff members for improprieties alleged to have occurred in the Central Region. On March 15, 1994 the NFA restructured the Business Conduct Committee and its function. As of that date, the Committee is no longer engaged in fact-finding or imposing discipline but rather its role is now limited to determining whether regulatory actions should be brought against those members before the Hearing Committee. The Hearing Committee is now the body which conducts fact-finding and imposes discipline.

2. Other Relevant Entities and Individuals

Sigma, Inc. is a Delaware corporation that was engaged in the solicitation, pooling and investment of clients' funds in the securities, commodities futures and options markets.

Chuckles Kohli was one of two directors and a principal officer of Sigma and other related enterprises. On March 6, 1996, Kohli plead guilty to federal charges of commodities fraud, wire fraud and income tax evasion. United States v. Chuckles Kohli, Criminal No. 96-132(AET).

Ramchandran was also one of two directors and a principal officer of Sigma. He is currently the subject of investigation by the United States Attorney's Office.

3. Plaintiffs' Allegations

A. General Allegations

The plaintiffs' Amended Complaint charges generally, that from as early as 1989 and until April 12, 1995, Kohli and Ramchandran, the sole shareholders and officers of the Sigma entities, solicited, on Sigma's behalf, approximately $41 million from 400 investors by falsely holding themselves out as experienced commodities and options traders. The majority of these funds was placed with the defendants. The Amended Complaint alleges that Kohli and Ramchandran solicited these funds from members of the public, including plaintiffs, to invest in commodities for future delivery as well as other commodities, future contracts and commodity options. Kohli and Ramchandran conducted this activity using the business names of Sigma, Inc.; Geronimo, Inc.; Vol Partners, L.P.; and Savid Group. The investor plaintiffs were informed their funds would be pooled and used to trade in the currency and other markets and signed Powers of Attorney giving Kohli, Ramchandran and the Sigma Entities discretionary authority over investing funds and trading decisions. Throughout the relevant time period, Kohli, Ramchandran and Sigma were engaged in fraudulent activity commonly referred to as a "Ponzi" scheme. A Ponzi scheme is one in which early investors who seek to withdraw their funds or their purported profits are paid with funds invested by subsequent investors, and ultimately the later funds are lost due to the fraud of the principals.

The Amended Complaint alleges generally, with respect to the named defendants, that Sigma opened one or more accounts with each of the defendants and entered trades through these accounts. The defendants aided in the execution of trades and sent confirmations and monthly account statements reflecting the transactions which had been executed. The Amended Complaint alleges that defendants never conducted due diligence or made inquiries with respect to the financial condition of Sigma or the source of the deposited funds. The Amended Complaint further alleges that the defendants never inquired into the status of the CFTC registration and NFA membership of Kohli, Ramchandran or Sigma and that defendants 'knew or should have known of the "Ponzi" scheme being perpetrated by Kohli and Ramchandran. The Amended Complaint asserts that as a result of the fraudulent "Ponzi" scheme, in which defendants participated, the investor plaintiffs lost approximately $55 million.

More specifically, plaintiffs allege that along with Kohli, Chandran and the Sigma Entities, the defendants "knowingly, with intent to deceive, with reckless disregard for the truth or conscious avoidance of the truth, in bad faith, withheld and/or failed to disclose" to plaintiff investors the following: 1) that Kohli, Chandran and the Sigma Entities were not appropriately registered or licensed; 2) that Kohli, Chandran and the Sigma Entities were not members of the NFA; 3) that the securities solicited and sold to plaintiffs were not registered as securities under state or Federal laws or regulation; 4) that Kohli and Chandran were not investing all funds obtained from the plaintiffs in commodity futures contracts or other legitimate investments, but were also using said funds to pay phony "profits" and for other business and

personal purposes; 5) that defendant FCMs and FCM EMPLOYEES earned commissions on every commodity futures contract trade made through the FCMs; 6) that defendant FCMs had not followed the rules and regulations of the CFTC and the NFA Manual concerning disclosure of information as required to be made to third party investors; 7) that some of the plaintiffs' funds were going to repay defendant FCMs for debit balances; and 8) that Kohli and Chandran had very little knowledge about commodity futures trading, did not maintain accurate and complete records, did not comply with the rules and regulations of the CFTC and the NFA Manual and created fictitious account statements. ¶ 90

B. Sigma's Relationship with Defendants

Plaintiffs' Amended Complaint alleges that Kohli, Chandran and the Sigma Entities approached each of the defendant FCMs some time between January 1, 1989 and April 12, 1995 to place orders to purchase or sell futures contracts. ¶ 64. Plaintiffs further allege that, "Once Kohli, Chandran and the Sigma Entities secured the initial core of plaintiff investors, they induced additional persons to invest through the Sigma Entities' false appearance of legitimacy. The appearance of legitimacy stemmed from the fact that although only a properly registered and licensed FCM or CPO may hold customers' money in an omnibus account, the FCMs allowed the Sigma Entities to deposit customers' funds in an account with the FCMs even though they were not registered as an FCM or a CPO." ¶ 65

Plaintiffs contend that during the relevant time period, the FCM defendants opened Special Accounts for investment

in commodities for Kohli and Chandran through business names of Sigma, Inc., Geronimo, Inc., Vol Partners, L.P. and Savid Group and these Special Accounts were all corporate and/or partnership accounts whose forms were completed by Kohli. ¶¶ 68, 69. Plaintiffs contend that in connection with opening a new account, the FCMs should have required the Sigma Entities to submit certain documentation and information, including financial statements and/or information of the principals of the company as well as certification indicating who from the company was authorized to conduct trades and transfers of money in and out of the account, but that the defendant FCMs failed to take such action. ¶ 69.

According to plaintiffs' Amended Complaint, the financial information which Kohli provided to the FCMs on account forms was inconsistent with the magnitude of the trading activity conducted in the accounts and the substantial losses sustained in the accounts over the relevant period and the volume of trading and trading losses as sustained in the accounts frequently exceeded the equity in the accounts and the net worth of the Sigma entities as shown on the financial information submitted to the defendant FCMs. ¶ 70. Plaintiffs assert that "in light of the material discrepancies between the reported financial information of the Sigma Entities, the volume of trading conducted in the accounts, the substantial losses which were being sustained in the accounts and the number of different individuals who were listed with trading authority on the accounts, defendant FCMs were aware that the accounts were being operated as commodity pools comprised of funds solicited from third party investors, therefore requiring registration pursuant to CFTC regulations and NFA rules." Plaintiffs assert that the failure of the FCMs

to perform minimal diligence with regard to the background of Kohli, Chandran and the Sigma entities was reckless and without regard for the truth. ¶ 71.

At various times, the accounts of Kohli and Chandran under the business names of the Sigma Entities carried lower balances with the defendant FCMs than necessary to meet the withdrawal demands of the plaintiffs and at times carried negative balances. According to plaintiffs, at these points Kohli and Chandran had to solicit additional funds from new investors so that the new investors' money could be placed in the accounts, thus concealing from the plaintiffs the true diminished value of their accounts. ¶ 85. Plaintiffs contend that defendant FCMs and FCM EMPLOYEES knew or should have known that most of the funds in the accounts of the Sigma Entities during the period of January 1, 1989 and April 12, 1995 had been obtained by Kohli and Chandran from third party investors by false pretenses and without proper regard to the requirements of the CEA, CFTC Regulations and the NFA Manual concerning commodity pool investments. ¶ 86. Plaintiffs also contend that defendants knew or should have known that the account of the Sigma Entities contained funds that Kohli, Chandran and the Sigma Entities were soliciting from the plaintiff class members who were innocent investors who believed their money was being pooled legally and properly invested in the commodities market. ¶ 88.

C. Disclosure Documents, Registrations Requirements and "Due Diligence"

Plaintiffs' Amended Complaint also contains allegations that the defendants failed to ascertain whether the

proper documents were filed or delivered to plaintiffs. Plaintiffs contend that the defendant FCMs and FCM EMPLOYEES never received from the plaintiffs an acknowledgment for receipt of the required Disclosure Document pursuant to 17 CFR § 4.24 from Kohli, Chandran and the Sigma Entities, nor a Written Statement explaining why a Disclosure Document is not required pursuant to NFA Compliance Rule 2-8(e). ¶ 77. Plaintiffs also assert that the FCMs and FCM EMPLOYEES did not confirm delivery of the required Disclosure Document by Kohli, Chandran and the Sigma Entities pursuant to 17 CFR § 4.21 of the CFTC Regulations and NFA Compliance Rule 2-13. ¶ 79. Plaintiffs also allege, upon information and belief, that the defendant FCMs and FCM EMPLOYEES did not deliver to plaintiffs the required Disclosure Document in the form mandated by 17 CFR § 1.55 and NFA Compliance Rule 2-26. ¶ 83.

Plaintiffs claim that the defendant FCMs and FCM EMPLOYEES failed to investigate and know their customers and failed to perform minimum due diligence by not contacting the CFTC and NFA to gather information regarding Kohli, Chandran and the Sigma Entities as the agents for the plaintiffs pursuant to NFA Compliance Rule 20-8a9e. ¶ 81. Plaintiffs further contend that the defendant FCMs and FCM EMPLOYEES violated the NFA Articles of Incorporation, Article III, § 1(f) and NFA Bylaw 1101 by carrying accounts, accepting and handling transactions in commodity futures contracts on behalf of non-members of the NFA who were required to be registered with the CFTC and transacting business with an unregistered person pursuant to the statutory makeup of 7 U.S.C. Sections 6d., 6e., 6k., and 6n. ¶ 82.

D. Allegations Against Saul Stone

Plaintiffs contend that defendant Saul Stone in particular knew or had reason to know of the illicit activities of Kohli, Chandran and the Sigma Entities because of prior involvement in similar "Ponzi" schemes. According to plaintiffs, in September of 1982 defendant Saul Stone received actual notice of a similar "Ponzi" scheme of fraud and deceitful practices perpetrated through and with the assistance of Saul Stone's offices and personnel. Plaintiffs contend that this put Saul Stone on notice as to the likelihood and foreseeability of such "Ponzi" schemes developing when it did not diligently supervise the activities of its personnel and when it did not comply with the rules and regulations of the CFTC, CME and NFA. ¶ 93. Further, in June of 1985, Saul Stone also received actual notice of a "Ponzi" scheme perpetrated through and with the assistance of its offices and personnel. ¶ 94. Plaintiffs contend that the failure of defendant Saul Stone and the other defendant FCMs to properly and diligently train, manage, supervise and investigate the activities of their respective FCM EMPLOYEES as Well as Kohli, Chandran and the Sigma Entities, facilitated the occurrence of the activities complained of. ¶ 95.

E. NFA Failure to take Action

Plaintiffs assert that despite the fact that defendant FCMs and FCM EMPLOYEES carried accounts, accepted orders and handled transactions on behalf of parties not members of the NFA – no disciplinary action has been taken by the defendant NFA and no thorough, diligent and vigorous investigative action has been initiated by the NFA concerning

the management and conduct of the FCMs and FCM EMPLOYEES. Further, plaintiffs contend that the NFA knew or should have known that defendant FCMs were failing to submit certain forms as required by 17 CFR § 17.01 and thus knew or should have known that Kohli was illegally acting as a Third Party Account Controller and took no action. ¶ 102. According to plaintiffs' Amended Complaint, the NFA received substantial income due to the trades and therefore, "due to the high volume of income generated by defendant FCMs for the benefit of the NFA, the NFA had an ulterior motive with little or no motivation to conduct a thorough and vigorous disciplinary investigation of the FCMs." ¶ 106

F. FCM Failure to Cease Trading with Sigma

Plaintiffs similarly contend that defendant FCMs failed to cease trading with the Sigma Entities, despite knowledge of its fraudulent activities, because of commissions obtained through such trading. Plaintiffs assert that at various times beginning in 1989, the defendant FCMs authorized and permitted their employees to hold themselves out as agents of their employers and as such accepted orders from Kohli, Chandran and the Sigma Entities for commodity futures transactions for which they received substantial commissions. ¶ 103. Plaintiffs contend that there were approximately 10,000 trades per month which were excessive under the circumstances, contrary to the best interests of investors and constituted "churning" of the account and due to the high volume of commissions generated by FCM EMPLOYEES the FCMs had little or no motivation to conduct a thorough and vigorous investigation of FCM EMPLOYEES and the activities of Kohli, Chandran and the Sigma Entities. ¶ 103.

G. Improper Transfers

Plaintiffs also contend that $710,000 in the Sigma Entities' Special Accounts at certain of the defendant FCMs were improperly transferred by those defendant FCMs upon instructions from Kohli to personal accounts maintained by Kohli. ¶ 73. Plaintiffs contend that a total of $590,000.00 was transferred from at least one account in the name of Geronimo at defendant Merrill Lynch to Kohli's personal account at Charles Schwab or Dean Witter. ¶ 74. Further, according to plaintiffs, $80,000 was transferred from a Merrill account in the name of Geronimo to Kohli's personal joint account with his wife at Schwab. ¶ 76. Plaintiffs also contend that a transfer in the amount of $40,000 was made from a Prudential account in the name of Sigma to Kohli's personal joint account with his then wife at Schwab. ¶ 76.

H. Involvement of FCM EMPLOYEES

Plaintiffs allege, as stated above, that as a result of the "Ponzi" scheme perpetrated by the Sigma Entities, they lost $ 55 million. Plaintiffs allege, upon information and belief that as of February 28, 1995, reports issued by Kohli and Chandran showed in the aggregate that the commodity pools operated by Kohli and Chandran had assets totaling at least $68 million and of this amount $55 million was lost through trading activities, and an additional $5 million was spent by Kohli and Chandran and $11.6 million was returned to investors. ¶ 60. Plaintiffs allege, upon information and belief that a portion of the $5 million spent by Kohli and Chandran was used to entertain FCM EMPLOYEES including employees of defendant Merrill Lynch at a December 1994 Florida golf trip and employees of defendant First Options at

golf outings, football games and other events in either New Jersey or Las Vegas in 1994. ¶ 61.

Further, with regard to the aforementioned $5 million of investor funds plaintiffs assert that some of the funds were used to pay for personal trips to Florida by Steve Kaczmer, who was employed first by defendant Linnco and then by defendant First Options. ¶ 62. Further, plaintiffs contend that the funds were used to pay a $10,000 per month salary to Kaczmer who, while trading during the day at First Options, traded at night for the Sigma Entities from his home terminal. Kaczmer also received from Kohli the sum of $60,0000 in the form of a "loan" of which only $40,000 was repaid; the remaining balance was "forgiven" by Kohli. ¶ 63.

I. Plaintiffs' Complaint

As a result of the above stated factual scenario, on February 13, 1997 the investor-plaintiffs filed an eleven count Complaint against the named defendants. The following causes of action were asserted in the original Complaint: Count One alleges a violation of the Commodities Exchange Act; Count Two alleges a breach of contract under New Jersey common law; Count Three alleges bad faith failure to enforce NFA rules; Count Four alleges a violation of the New Jersey Uniform Securities Law; Count Five alleges violations of the Securities Act of 1933, Count Six alleges violations of the Securities Act of 1934; Count Seven alleges a breach of fiduciary duty; Count Eight asserts negligence; Count Nine alleges a violation of RICO; Court Ten alleges fraud and civil conspiracy; and Court Eleven alleges a violation of the New Jersey Consumer Protection statute. On November 24, 1997, plaintiffs filed their First Amended Class Action Complaint.

The Amended Complaint contained the same claims as the original with the exception of Counts Five and Six, which were omitted.

Defendants now move to dismiss plaintiffs' complaint in its entirety for a variety of reasons. Defendant have also moved for the imposition of sanctions pursuant to Fed. R. Civ. P. 11.

DISCUSSION

1. Personal Jurisdiction - Defendants Delbridge and Stone

The only specifically identified individual defendants in the instant case are Clarence Delbridge and Thomas Stone. Mr. Delbridge and Mr. Stone are named in the claims for breach of contract, bad faith failure to enforce NFA rules, and breach of fiduciary duties. According to plaintiffs' Amended Complaint, defendants Delbridge and Stone's wrongdoing stems from their dual capacity as (a) executives of Saul Stone & Co., and (b) members of certain National Futures Association committees. The Amended Complaint alleges that the individual defendants are liable to plaintiffs because they failed to detect and report to the NFA various misdeeds of non-parties.

The individual defendants have not consented to the exercise of personal jurisdiction by this Court and they contend that there are no relevant contacts between either Mr. Delbridge or Mr. Stone and this forum and the fact that they are employed by Saul Stone & Company or serve on NFA committees does not create personal jurisdiction over them.

They have moved to dismiss the claims against them pursuant to Fed. R. Civ. P. 12(b)(2). As their motion raises issues of this Court's jurisdiction, this Court will address it as an initial matter.

When a defendant challenges the court's in personam jurisdiction, the plaintiff must show that the defendant had sufficient contacts with the forum. Time Share Vacation Club v. Atlantic Resorts. Ltd., 735 F.2d 61, 63 (3d Cir. 1984). Where the issue is presented in a motion to dismiss, the Court must accept as true the allegations in the complaint and resolve disputed issues of fact in favor of the plaintiff. Carteret Savings Bank v. Shushan, 954 F.2d 141, 142 n. 1 (3d Cir.) cert. denied, 113 S.Ct. 61 (1992).

Generally, the law of the state in which the district court sits governs whether the district court may assert personal jurisdiction over a nonresident defendant. Fed. R. Civ. P. 4(e); Dent v. Cunningham, 786 F.2d 173, 175 (3d Cir. 1986). A Federal Court sitting in New Jersey, therefore may exercise jurisdiction over any person who would be subject to the jurisdiction of the courts of the state of New Jersey. Fed. R. Civ. P. 4(e); North Penn Gas Co. v. Corning Natural Gas Corp., 897 F.2d 687, 689 (3d Cir.) cert. denied, 498 U.S. 847 (1990). New Jersey's long arm statute, Civil Practice Rule 4:4-4(c)(2), allows a court to exercise personal jurisdiction over non-resident defendants to the fullest extent permitted by the Due Process Clause of the Fourteenth Amendment to the United States Constitution. DeJames v. Magnificence Carriers, Inc., 654 F.2d 280, 284 (3d Cir.) cert. denied, 454 U.S. 1085 (1981).

For the exercise of jurisdiction to conform with the Fourteenth Amendment, it must be shown that a defendant has had "minimum contacts" with the forum state, so that it would be "'reasonable . . . to require the corporation to defend the particular suit which is brought there.'" World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 291-292 (1980) (quoting International Shoe Co. v. State of Washington Office of Unemployment, 326 U.S. 310, 317 (1945)). There are two grounds for asserting in personam jurisdiction. First, the court may find that the defendant has had sufficiently continuous and systematic contacts with the forum to support "general jurisdiction." Helicopteros Nacionales de Columbia, S.A. v. Hall, 466 U.S. 408, 414 n.8 (1983). Second, if the cause of action is related to or arises out of the defendant's activities within the forum, the court may exercise "specific jurisdiction." Id.

Personal jurisdiction over the defendants does not exist simply because they are agents or employees of organizations which presumably are amenable to personal jurisdiction in this Court. Keeton v. Hustler Magazine, Inc., 465 U.S. 770, 781 (1984). The law is clear that a corporate officer or agent who has contact with the forum state only with regard to the performance of corporate duties does not thereby become subject to jurisdiction in his or her individual capacity. Forsythe v. Overmyer, 576 F.2d 779, 783-84 (9th Cir.) cert. denied, 439 U.S. 864 (1978); Arkansas Rice Growers v. Alchemy Industries, Inc., 797 F.2d 565 (8th Cir. 1986). Further, a person generally acting as an agent on behalf of a corporation is not individually subject to personal jurisdiction merely based on his actions in a corporate capacity. TJS Brokerage & Co. v. Mahoney, 940 F.Supp. 784, 788-89 (E.D. Pa. 1996). Each defendant's contacts with the forum

state must, therefore, be evaluated individually. See Rush v. Savchuk, 444 U.S. 320, 332 (1980). See also PSC Prof. Serv. Group v. American Digital Systems, 555 F.Supp. 788, 791 n.5 (E.D. Pa. 1983) (It is well settled that, absent allegations that the corporate shield is a sham, jurisdiction over the corporation does not subject officers, directors and shareholders of the corporation to personal jurisdiction). Therefore, this Court must assess the contact of defendants Delbridge and Stone with the forum state in their individual capacities.

In the instant case, plaintiffs have not alleged any contact defendants Delbridge and Stone had with the forum New Jersey. Defendants Delbridge and Stone did not reside in New Jersey, did not visit here, did not own property here or even have any personal contact with the forum state. This Court cannot, therefore, find that defendants have systematic and continuous contacts with New Jersey. Further, defendants Delbridge and Stone never communicated with plaintiffs in New Jersey and never spoke or corresponded with anyone purporting to represent the Sigma entities. Therefore, this court cannot find that defendants Delbridge and Stone took any action by which they purposefully availed themselves of the privilege of conducting activities within the forum state or that would justify haling them into Court in this state. Considering this lack of any allegation that defendants had the requisite minimum contacts in their individual capacities, this Court cannot find that either specific or general jurisdiction exists over them.

As a final matter, this Court notes that plaintiffs have argued that subsection 25(c) of the Commodity Exchange Act provides this Court with personal jurisdiction over defendants

Delbridge and Stone. Subsection 25(c) of the CEA provides, in pertinent part, that "any action brought under subsection (a) of this section may be brought in any judicial district wherein a defendant is found, resides, or transacts business, or in the judicial district wherein any act or transaction constituting the violation occurs." 7 U.S.C. § 25(c). However, defendants contend, and this Court agrees that the above-stated provision is a venue provision, not a jurisdictional one, and as such, does not provide this Court with personal jurisdiction over the individual defendants. Therefore, while venue may be appropriate in the District of New Jersey -- without an independent basis of personal jurisdiction over defendants, the above stated venue provision cannot provide this Court with such jurisdiction.

2. Fed. R. Civ. P. 12(b)(6)

The court cannot dismiss an action under Rule 12(b)(6) unless it appears beyond doubt that the plaintiff can prove no set of facts in support of the claims as plead which would entitle the plaintiff to relief. Conley v. Gibson, 355 U.S. 41, 45-46 (1957). The factual allegations raised in the complaint must be assumed to be true. Jenkins v. McKeithen, 395 U.S. 411, 421 (1969); Kost v. Kozakiewicz, 1 F.3d 176, 183 (3d Cir. 1993). The complaint should be construed liberally in the plaintiff's favor, giving that party the benefit of all fair inferences which may be drawn from the allegations. Wilson v. Rackmill, 878 F.2d 772, 775 (3d Cir. 1989). "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." Scheuer v. Rhodes, 416 U.S. 232, 236 (1974).

3. Defendants GNI Incorporated and GNI Limited

This Court notes that defendants GNI Incorporated and GNI Limited filed motions to dismiss the Complaint with regard to them, however as the parties have stipulated to the dismissal of these defendants, and an Order to that effect has been entered, this Court will deny the motions of GNI Incorporated and GNI Limited as moot.

4. Count One: The Commodities Exchange Act

Count One of plaintiffs' Amended Complaint alleges a violation of the Commodities Exchange Act by defendant FCMs and FCM employees, asserting that these defendants carried accounts, accepted orders and handled commodity futures contracts for Kohli, Chandran and the Sigma Entities, all non-Members of the NFA, exceeding their authority, as agents for the plaintiffs. ¶ 127. Plaintiffs further contend that Kohli, Chandran and the Sigma Entities were a fiction under the CEA of which the FCMs and FCM employees were aware, or with required minimal due diligence would have discovered. ¶ 128. In Count One of the Amended Complaint, plaintiffs contend that defendants were both primary violators of the Commodity Exchange Act and aiders and abettors of Commodity Exchange Act violations.

Section 25 of the Commodity Act provides, in pertinent part, that:

> Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this

chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person --

> (A) who received trading advice from such person for a fee;
>
> (B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;
>
> (C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of--
>
> > (i) an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade);
> >
> > (ii) a contract subject to section 23 of this title, or

> (iii) an interest or participation in a commodity pool; or
>
> (D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

7 U.S.C. § 25(a)(1)(A)-(D). Section 25(a)(2) states that, except under certain circumstances not relevant here, "the rights of action authorized by this subsection . . . shall be the exclusive remedies under this chapter available to any person who sustains loss as a result of any alleged violation of this chapter." 7 U.S.C. § 25(a)(2). The Commodity Act also provides at 7 U.S.C. § 13c(a) that:

> Any person who commits, or willfully aids abets, counsels, commands, induces, or procures the commission of a violation of any of the provision of [the Commodity Act], or any of the rules, regulations, or orders issued pursuant to [the Commodity Act], . . . may be held responsible for such violations as a principal.

Therefore, the CEA creates a private cause of action in limited circumstances for both direct violations of the CEA and aiding and abetting violations of the CEA.

A. Direct Violations

Plaintiffs contend that defendants are primary violators of subparagraphs (A), (B) and (C) of 7 U.S.C. § 25(a)(1). Plaintiffs first contend that the defendant FCM's provided trading advice to plaintiffs for a fee in violation of subparagraph (A) because they regularly advised the Sigma entities what they could or could not trade. More specifically, plaintiffs contend that defendants gave advice to guide plaintiffs accounts around margin requirements and to allow Kohli to maximize the number of trades in order to maximize their own commission fees." Plaintiffs contend that this places defendant FCM in the shoes of "such person" listed in subparagraph (A).

As the FCM defendants had no contact with the investor plaintiffs, there is no allegation in the instant case that defendants directly gave plaintiffs advice, rather plaintiffs allege an "agency" theory in which defendants' alleged acts of giving trading advice to Kohli, who is alleged to be plaintiffs' agent, constitutes the giving of advice to plaintiffs in satisfaction of subparagraph (A). Plaintiffs have provided no authority for allowing a section 25 relationship to be established through an agency theory and there is no indication in the statute indicating the availability of such relief. Further, this Court notes that allowing such a theory in the instant case, where Kohli, although technically the agent of the plaintiff was clearly not operating in plaintiffs' interest does not seem appropriate.

Subparagraph B of Section 25(a)(1) which relates to contracts for sale of commodities for future delivery, will support a cause of action if the plaintiff made the contract of sale through the defendant or deposited with or paid to the defendant money, securities or property in connection with

the order to make such a contract. 7 U.S.C. § 25(a)(1)(B); Grossman v. Citrus Assoc. of the New York Cotton Exchange, Inc., 706 F.Supp. 221, 230 (S.D.N.Y. 1989). Plaintiffs also contend that defendants accepted orders from plaintiffs for futures and options contracts and/or accepted deposits from plaintiffs in violation of subparagaph (B). This argument is based on the theory that as Kohli was the agent of the plaintiffs, accepting trades from him was the equivalent of accepting trades from plaintiffs in violation of 7 U.S.C. § 25(a)(1)(B). For the reasons stated above, this court finds that plaintiffs have failed to establish a relationship under Subparagraph B of § 25.

Subparagraph C permits an individual to maintain a private action against persons who purchased an interest or participation in a commodity pool or sold such an interest to that pool. Plaintiffs contend that defendants created pool interests by allowing the Sigma entities to trade without margin and that undermargined positions were eventually transferred to plaintiff and that "this overt act of ignoring required margins places defendant FCM's in the position of both primary violator of subparagraph C and as a aiders and abettors of such a violation." Plaintiffs do not allege that the FCM defendants sold them any such interest, but rather admit that the interest or participation in commodity pools were sold to them by Kohli, Chandran and the Sigma entities. As plaintiffs again rely on an agency theory, this Court does not find that plaintiffs have stated the required relationship under Subparagraph C.

As plaintiffs have failed to state any of the required relationships under § 25(a), their claim for a direct violation of the CEA must be dismissed.

B. Aiding and Abetting Liability

Plaintiffs's Amended Complaint also alleges that defendants aided and abetted violations of the CEA. Plaintiffs contend that they were denied the opportunity to properly evaluate investing in Sigma because Kohli and Sigma were unregistered and that by allowing Kohli to open accounts and by ignoring or relaxing margin rules, the FCM defendants aided and abetted Sigma to continue trading when underfunded. Plaintiffs contend that as Kohli was not properly registered as required under the CEA and as the defendant FCMs carried accounts, accepted orders and handled futures contracts for Sigma that "common sense dictates that the FCM defendants also aided and abetted Kohli and the Sigma entities."

Defendants contend that plaintiffs' claim of aiding and abetting CEA violations cannot be maintained against them because they are not parties that can be held liable under the statute. This Court must determine, therefore, against whom the private right of action for aiding and abetting can be maintained. Defendants assert that plaintiffs' claims for aiding and abetting commodities fraud violations must be dismissed because there is not a "buyer-seller relationship" between the FCM defendants and the plaintiffs and such relationship is a condition precedent to a private right of action under the Commodities Exchange Act. Plaintiffs contend that the statute does not require that the alleged aider and abettor be in one of the relationships set out in 7 U.S.C. § 25(a)(1)(A) - (D) with the plaintiff, but rather that only the principal must satisfy this requirement.

- This Court notes that this issue is not settled. With the exception of this Court, no Court in the Third Circuit has spoken on this issue. However, this Court held in Manley v. Stark & Stark, Civ. No. 97-524(AET) that under section 25(a)(1) a primary violator must be the "such person" who commits one of the enumerated acts in subsections (A)-(D); in other words defendants must have provided plaintiffs with trading advice for a fee, made any contract of sale of any commodity for future delivery or accepted the deposit of money, securities or property in connection with any order to make such contract; or sold to or accepted the order for the purchase or sale of or interest or participation in a commodity pool. In so finding, this Court followed the majority of Courts to have spoken on this issue and found that in order to establish aider and abettor liability, plaintiffs must be in one of the four above stated relationships with the defendants. See also Damato v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 878 F.Supp. 1156, 1161 (N.D. Ill. 1995) (holding that the only persons subject to a private right of action under § 25(a) of the CEA are those who sold or took orders for interests in the commodity pool); Davis v. Coopers & Lybrand, 787 F.Supp. 787 (N.D. Ill, 1992) (same); In re Lakes States Commodities, Inc., 936 F.Supp. 1461, 1467 (N.D. Ill. 1996) (Stating, "Congress could not have more clearly pronounced its intention to create only one vehicle for private causes of action . . . and given recent Supreme Court teachings on statutory construction, we are loathe to imply a private right of action into § 13(a)."); Grossman v. Citrus Assoc. of N.Y. Cotton Exchange, 706 F.Supp. 221, 2312 (S.D.N.Y. 1989); Kolbeck v. LIT America, Inc., 923 F.Supp. 557, 566 (S.D.N.Y. 1996).

Plaintiffs argue that this Court should reverse its earlier decision, and ignore the above stated cases and find that a buyer-seller relationship is not required in order to state a cause of action for aiding and abetting under the Commodities Exchange Act. In support of this position, plaintiffs have provided this Court with an amicus curiae brief submitted by the CFTC to the Seventh Circuit Court of Appeals in the D'Amato case advocating a broader reading of possible aiding and abetting liability. Although noting the argument of the CFTC to the contrary, this Court finds that the statute on its face appears to preclude private rights of action against either a principal or an aider and abettor absent the existence of one of the four relationships described in § 25(a)(1). Further, it would appear from reading § 25(a)(2) that a private right of action is not available outside the confines of § 25(a)(1). Therefore, this Court will follow the reasoning of the majority of courts to speak on this issue and preclude a private right of action absent one of the relationships listed in § 25. As this Court has found above that no such relationship has been adequately alleged in the instant case, Count I must be dismissed.

5. Count Two: Breach of Contract

In the second count of their Amended Complaint, plaintiffs allege a violation of New Jersey common law regarding contracts against defendants FCMs, FCM EMPLOYEES and the NFA. More specifically, plaintiffs allege that they were third party beneficiaries of the agreements between the NFA and its members. ¶ 137. In particular, plaintiffs rely upon NFA Bylaw 1101 and NFA Compliance Rule 2-8(e) as the sources of their purported contractual rights. ¶ 143

NFA Bylaw 1101 provides that:

> No Member may carry on an account, accept an order or handle a transaction in commodities futures contracts for or on behalf of any non-Member of the NFA, or suspended Member, that is required to be registered with the Commission [CFTC] as an FCM, IB [Introducing Broker], CPO, CTA or LTM [Leverage Transaction Merchant], and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or other person.

The interpretive notice regarding Bylaw 1101 states in part that, "the Rule, by its terms imposes strict liability on any Member conducting customer business with a non-Member that is required to be registered. The Rule does not require proof that the Member firm was at fault or failed to exercise due diligence -- simply that it transacted customer business with a non-Member that is required to be registered." NFA Compliance Rule 2-8(e) provides the "[n]o member FCM shall accept a customer account and no Member FCM or IB shall introduce a customer account over which a third party, not an associate of such FCM or IB, is to exercise discretion" without first obtaining an authorization from the customer and an acknowledgment from that customer that they received certain disclosure documents.

Based on the alleged violation of this Bylaw and Compliance Rule, plaintiffs contend they are entitled to bring a claim for breach of contract as third party beneficiaries of

the contract between the defendant NFA and its members, the defendant FCMs. Plaintiffs claim that members of the general public are third party beneficiaries of the NFA Manual and are entitled to recover from the NFA under a breach of contract theory every time that a scheme to defraud involving the futures market is perpetrated. Defendants contend that this claim must fail as the general public are not third party beneficiaries of the NFA's contract with its members. The defendants further contend that general statements of the NFA's desire to benefit the general investing public cannot support a third party beneficiary claim for breach of contract as there is no evidence that the NFA and its members intended to bestow contractual rights on the general public under the NFA Manual or Bylaws.

In New Jersey, a third party beneficiary may sue upon a contract made for his or her benefit without being privy to the contract. Rieder Communities, Inc., v. North Brunswick Tp., 227 N.J. Super. 214, 222 (App. Div. 1988), cert. denied, 113 N.J. 638 (1988); see also N.J.S.A. 2A:15-2 (providing that a person for whose benefit a contract is made may sue on the contract in any court). The standard for determining third-party beneficiary status is "whether the contracting parties intended that a third party should receive a benefit which might be enforced in the courts . . ." Rieder, 227 N.J. Super. at 222 (quoting Brooklawn v. Brooklawn Housing Corp., 124 N.J.L. 73, 77 (E & A, 1940). Absent such a conclusion derived from the contract or surrounding circumstances, "a third party has no cause of action despite the fact that it may derive an incidental benefit from the contract's performance." Rieder, 227 N.J. Super, at 222 (citing Gold Mills, Inc. v. Orbit Processing Corp., 121 N.J. Super. 370, 373 (Law Div. 1972).

When considering the intent of the contracting parties, however, "it is not necessary that an intended beneficiary be identified when the contract containing the promise is made," nor is it necessary for the promises's obligation to the intended beneficiary to be in existence at the formation of the contract. Werrmann v. Aratusa, LTD., 266 N.J. Super. 471, 476-77 (App. Div. 1993). The "real test" in determining if a party is a third-party beneficiary to a contract is "whether the contracting parties intended that a third party should receive a benefit which might be enforced in the courts." Brooklawn v. Brooklawn Housing Corp., 124 N.J.L. 73, 11 A.2d 83 (1940); accord Air Master Sales Co. v. Northbride Park Co-op, Inc., 748 F. Supp. 1110, 1117 (D.N.J. 1990). A third-party, who is not an intended beneficiary, but incidentally benefits from a contract, has no contractual right to enforce the contract. See Grant v. Coca-Cola Bottling Co., 780 F. Supp. 246, 249 (D.N.J. 1991).

There is simply no indication in the instant case that plaintiffs were the intended beneficiaries of the contractual relationship between the NFA and its FCM members. Plaintiffs find evidence of an intent to benefit them in the broad proclamations made concerning the association's desire to protect the investing public and the following language from Interpretive Notice regarding Bylaw 1101, "the suggested procedures should help foster . . . greater protection to the investing public." This language does not affirmatively indicate any desire to permit non-parties to enforce its terms. The Bylaw and Compliance Rule relied upon by the plaintiffs in this case do not indicate that non-parties have the right to seek private judicial remedies to enforce the agreement.

Further, third party enforcement of the rules of a self-regulator, organization has been considered and rejected by a number of other Courts. See Lake States Commodities, 936 F.Supp. 1461 (N.D. Ill. 1996) (NFA Bylaw 1101 and Compliance Rule 2-8(e), relied upon by plaintiffs in this case do not indicate that non-parties have the right to seek private judicial remedies to enforce the agreement. Without such language, the plaintiffs cannot claim third-party beneficiary status); Bloch v. Prudential-Bache Sec., 707 F.Supp. 189, 195-96 (W.D. Pa. 1989) (concluding that allowing third-party beneficiary claims under NYSE and NASD rules seems incongruous with the large body of case law holding that no private cause of action exists for violations of the rules of self-regulatory organizations); Pittsburgh Terminal Corp. v. Baltimore & Ohio R. Co., 509 F.Supp. 1002 (W.D. Pa. 1981) rev'd on other grounds, 680 F.2d 933 (3d Cir.) cert. denied 459 U.S. 1056 (1982) (Court refused to allow a third party claim for violation of NYSE rules);

Plaintiffs have cited several New Jersey cases in which third party beneficiary status has been found in the context of insurance. See Eschle v. Eastern Freight Ways. Inc., 128 N.J. Super, 299, 306 (1974); Wermann v. Aratus, Ltd., 266 N.J. Super. 471 (App. Div. 1993). However, these cases are clearly distinguishable and do not support a finding by this Court that a third party beneficiary relationship, upon which a private right of action can be based was created by the contractual relationship between the NFA and the FCM defendants. As there is no indication that the NFA and its members intended to bestow contractual rights on the public under the NFA Manuals or Bylaws, plaintiffs' third party beneficiary claim must be dismissed. Therefore, Count II of

plaintiffs' Amended Complaint alleging breach of contract will be dismissed.

6. Count Three: Bad Faith Failure to Enforce NFA Rules

Count Three is asserted by plaintiffs pursuant to the CEA, 7 U.S.C. § 25(b) and the regulations established pursuant to the CFTC against defendant NFA. Plaintiff asserts that the NFA acted in bad faith in failing to enforce its own Bylaws and Rules as set forth in the NFA Manual, pursuant to 7 U.S.C. § 21(b)(8).

Section 21(b)(8) states that "the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violations of its rules." The CEA states at § 25(b)(2) that a registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title, or in enforcing any such bylaw or rule violates this chapter or any Commission rule, regulation or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule. In order to be liable under these provisions, a contract market or clearing market must fail to enforce a bylaw, rule or regulation that is required to be enforced by Section 17 of the CEA.

Defendants allege that the NFA prohibition against doing business with non-members that is contained in Bylaw 1101 is not a bylaw required by Section 17 of the CEA and thus no private cause of action can be enforced for its non-enforcement. The NFA adopted Bylaw 1101, which indirectly compels membership in the NFA for all Commission registered FCMs pursuant to Section 17(m) of the CEA. Section 17(m) of the CEA provides that "the Commission may approve rules of futures associations that, directly or indirectly, require persons eligible for membership in such associations to become members of at least one such association . . ." Defendants contend, and this Court agrees, that the plain meaning of the word "may" in Section 17(m) permits the NFA to adopt rules such as Bylaw 1101, but does not require the NFA to do so as a condition.

Similarly, Rule 2-8(e) is not one of the Rules which the CFTC required under § 17 of the CEA as a condition to its authorization to the NFA to be a RFA. In fact, the CFTC approved the NFA's application for membership before Rule 2-8(e) was in existence, thus indicating that any requirements of the CEA were fully satisfied by the existing Rules 2-8(a) through 2-8(d). The NFA was in existence for four years before Rule 2-8(e) was added. This Court cannot, therefore, find that Rule 2-8(e) was a rule required by the CFTC, but rather it is a discretionary Rule passed by the NFA only to assist its members in their own internal compliance with Bylaw 1101 and as such, it cannot provide the basis for a private right of action against the NFA.

Courts have consistently held that Section 22 does not provide any private remedy for purported violations of CFTC Regulations and NFA Bylaws and rules. Courts have declined

to imply a private cause of action into NFA Bylaw 1101 and its Interpretive Notice. Lake States Commodities, Inc., 936 F.Supp. 1461, 1469 (N.D. Ill. 1996) (declining to imply a cause of action into [NFA] Bylaw 1101 and its Interpretive Notice and holding that plaintiffs who had invested money with unregistered commodity pool operator failed to state a claim under the CEA against futures commission merchant). Courts have similarly declined to imply a private cause of action into other NFA rules. See In re Indemnified Capital Invs., S.A. v. R.J. O'Brien & Associates, Inc., 12 F.3d 1406, 1412 (7th Cir. 1993). See also Davis v. Coopers and Lybrand, 787 F.Supp. 787 (N.D. Ill. 1992) (The exclusive private remedy under CEA does not include a cause of action for violations of CFTC regulations.); In re Soybean Futures Litigation, 892 F.Supp. 1025 (N.D. Ill. 1995) (Neither Section 4a nor Section 22 authorize private enforcement of CFTC regulations nor have courts been willing to recognize such a claim); Khalid Bin Alwaleed Found. v. E.F. Hutton & Co., 709 F.Supp. 815, 820 (N.D. Ill. 1989) (finding that Congress did not intend that the rules promulgated by the CFTC should give rise to a private cause of action); Unity House, Inc. v. First Commercial Financial Group, 1997 WL 701345 at * 4 (N.D. Ill. Nov. 5, 1997) (the CFTC and the NFA rules do not provide causes of action); Indemnified Capital Investments. S.A. v. R.J. O'Brien & Assoc., 12 F.3d 1406, 1412 (7th Cir. 1993) (dismissing investment company's action against FCM because no independent private right of action existed under NFA Compliance Rule 2-4 concerning just and equitable principles of trade); Birotte v. Merrill Lynch, Pierce, Fenner and Smith, Inc., 468 F.Supp. 1172, 1180 (D.N.J. 1979) (holding that there is no implied federal right of action for alleged violations of the New York Stock Exchange and Chicago Board Options Exchange Rules).

7. Count Four: New Jersey Uniform Securities Law

Count Four is asserted pursuant to the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47 et seq., against defendants FCMs and FCM EMPLOYEES as primary offenders, or in the alternative, as secondary offenders.

N.J.S.A. 49:3-71 (a)(2) and (b) provide:

(a) Any person who

(2) Offers or sells a security in violation of subsection (a) or (c) of [N.J.S.A.] or by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading (the buyer not knowing of the untruth or omission), is liable to the person buying the security from him . . .

(b) Every person who directly or indirectly controls a seller is liable under paragraph (a) . . . and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with and to the same extent as the seller, unless the nonseller who is so liable sustains the burden of proof that he did not know, and in the exercise of reasonable care could not

> have known, of the existence of the facts by reason of which the liability is alleged to exist.

The text of Section 49:3-71, therefore, requires that the offender must offer or sell securities to the aggrieved purchaser of those securities, or "materially aid" in the sale of those securities.

To be a "seller" of securities the defendant must pass title to the security to the plaintiff, or defendant must solicit plaintiff to purchase the security. Pinter v. Dahl, 486 U.S. 622 (1988). Mere allegations that the defendant's participation in the transaction was a substantial factor in causing the sale to occur is insufficient to establish that the defendant is a statutory seller. Zendell v. Newport Oil Corp., 226 N.J. Super. 431, 440-441 (App. Div. 1988). To establish liability on the part of a broker-dealer for "materially aid[ing] in the sale of a security, the plaintiff must demonstrate that the broker-dealer's involvement in the sale is "considerable, significant or substantial." Schor v. Hope, 1992 U.S. Dist. LEXIS 1003, 15-17 (E.D. Pa. 1992).

Defendants contend that the FCM defendants are not alleged to have "offered or sold" any securities so as to incur liability under the statute and further that they did not "materially aid in the sale" of securities so as to face liability under the statute. Defendants further contend that plaintiffs have also failed to allege that the FCM defendants played a "substantial role in persuading or seducing the purchasers into buying securities." Craighead v. E. F. Hutton & Co., 899 F.2d 485, 493 (6th Cir. 1990).

This Court finds no allegation which supports a finding that defendants either passed title to the securities in question or were involved in the sale to the extent required by law. There are no allegations that defendants in this case had any contact with plaintiffs, so as to solicit or persuade plaintiffs to purchase securities.

Plaintiffs also contend that defendants aided and abetted in a violation of the statute. The Restatement of Torts provides that a person is liable for harm resulting to a third person from the conduct of another when he "knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the others so to conduct himself. Restatement (Second) of Torts § 876(b). Courts have recognized that the Restatement provision sets forth the standard for civil aiding and abetting, See Landy v. Federal Deposit Ins. Corp., 486 F.2d 139, 162 (3d Cir. 1973) cert. denied 416 U.S. 960 (1974).

In this case, this Court cannot find that plaintiffs' allegations support a claim that defendants aided and abetted a violation of the statute. Even accepting all of plaintiffs' allegations as true and reading all inferences in favor of plaintiffs, plaintiffs have not alleged sufficient facts to indicate that defendants gave Kohli substantial and knowing assistance in the sale of securities. Therefore, Count IV fails to state a claim for either a direct violation of or aiding and abetting a violation of the Uniform Securities Act.

8. Count Seven: Breach of Fiduciary Duties

Count Seven is brought pursuant to common law and is asserted against defendant FCMs, FCM EMPLOYEES,

Delbridge, Stone and the NFA. Plaintiffs assert that the named defendants knew or should have known in the exercise of reasonable care that the money invested by Kohli and Chandran was the property of the plaintiff class members and that defendants, as fiduciaries with respect to the plaintiff class members were required to exercise reasonable and prudent discretion in connection with such transactions in the best interest of plaintiff. ¶ 182. Plaintiffs contend that the NFA as a non-profit organization charged with self-regulation, had a duty to protect the public interest, and thus had a duty to protect the plaintiffs in this case. Plaintiffs further contend that the NFA breached that fiduciary duty to the investing public when it failed to uncover the fraud at issue in the instant case. Defendants argue that in the absence of any allegation of a transactional relationship or other dealings between plaintiffs and defendants, defendants clearly owe no fiduciary duty to plaintiffs.

Under New Jersey Law, a confidential or fiduciary relationship encompasses all relationships "whether legal, natural, or conventional in their origin, in which confidence is naturally inspired, or in fact, reasonably exists." Pascale v. Pascale, 113 N.J. 20, 33-34 (1988). A fiduciary, therefore is a person with a duty to act primarily for the benefit of another. For a breach of fiduciary duty claim to succeed, plaintiff must show that either the particular relationship presumes fiduciary duties, or that the particular facts indicate that within this particular relationship, fiduciary duties have arisen. Hensler v. Busey Bark, 231 Ill. App. 3d 920, 927 (4th Dist. 1992).

Plaintiffs claim that the NFA manual and the CEA make the NFA "fiduciaries or quasi-fiduciaries" to the

plaintiffs in their dealings with Kohli, Chandran and Sigma which required the NFA to exercise reasonable and prudent discretion in connection with such transactions in the best interest of plaintiffs, and that defendants breached such duty. This Court disagrees. Plaintiffs contend that the NFA breached a fiduciary duty to the investing public when it failed to uncover the fraud at issue here. Plaintiffs have provided no support for their contention that a fiduciary duty is owed to them by with the NFA or the FCM defendants. Further, the lack of relationship between the plaintiffs and defendants forecloses the possibility that a fiduciary relationship existed between them. See Melrose v. Shearson/American Express, 1988 WL 9042, *12-13 (N.D. Ill. 1998) (lack of interaction bars a fiduciary duty claim -- a fiduciary duty is created by interaction between two parties, plaintiff cannot unilaterally impose a fiduciary duty upon the defendant). Considering these factors, this Court will follow a number of other Courts which have held that neither federal commodities laws, nor the NFA's Rules or Bylaws give rise to a relationship of trust and dominance so as to establish a fiduciary relationship. See Indemnified Capital Invs. S.A. v. R.J. O'Brien & Assocs., 12 F.3d 1406, 1411-12 (7th Cir. 1993) (no fiduciary duty created by NFA Compliance Rule 2-4); Baird v. Franklin, 141 F.2d 238, 239 (2d Cir. 1944) (no fiduciary duty arising from the stock exchange's requirement to investigate member wrongdoing); Spicer v. Chicago Board of Trade, 1990 WL 172712 at *15 (N.D. Ill. October 30, 1990) aff'd 977 F.2d 255 (7th Cir. 1992) (fiduciary duties are not lightly inferred . . . we conclude that the CBOE and OCC are not in a fiduciary relationship with investors who buy or sell options through their facilities); Arneil v. Ramsey, 414 F.Supp. 334, 343 (S.D.N.Y. 1976) (no fiduciary relationship between exchange and public customers of member firms); Piemonte

v. Chicago Board of Options Exchange, Inc., 405 F.Supp. 711, 718 n.4 (S.D.N.Y. 1975) (same); Steinberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 1974 WL 411 at *1 (S.D.N.Y. 1974) (New York Stock Exchange has no fiduciary duty to investors arising from its statutory duty to supervise brokers). Therefore, this Court finds that even accepting plaintiffs' allegations as true and reading all inferences in favor of plaintiffs, they have failed to state a claim upon which relief can be granted and their claim for breach of fiduciary duty is dismissed.

This Court notes that defendant NFA has raised the issue of preemption with regard to the common law claims made against it in plaintiffs' complaint. The NFA states that allowing a plaintiff to bring a state law claim against a self regulatory organization which is an integral part of the CEA's self-regulatory) scheme would frustrate Congress' intent to bring the markets under a uniform set of regulations. However, as all of the plaintiffs' claims which named the NFA as a defendant have failed to state a claim upon which relief can be granted and thus cannot be maintained, this Court need not address defendant NFA's contention that the maintenance of claims against it would be inappropriate.

9. Count Eight: Negligence

In Count Eight, plaintiffs assert a claim pursuant to common law against defendants FCMs and FCM EMPLOYEES for failure to exercise reasonable care and acting in a negligent manner. ¶ 189-190. Plaintiff contends that the FCMs and FCM EMPLOYEEs were negligent in failing to conduct a more thorough investigation of the source of funds invested by Kohli and Chandran; by assisting and

encouraging Kohli and Chandran in soliciting investors for commodity futures trades; by failing to adequately train their respective agents with regard to the laws and regulations governing commodity futures trading and the NFA Ethics Rules and in failing to diligently supervise the activities at their respective offices and solicitation of accounts traded through their respective offices. ¶ 190. Defendants contend that as they owed no duty to the plaintiffs, they cannot be held liable under a negligence theory.

New Jersey law applies to plaintiffs' claim of negligence. New Jersey law requires that in order to state a cause of action for negligence, a plaintiff must allege and prove a set of facts showing he has a substantive right entitling him to maintain a cause of action and that there is a violation of that right by defendant which causes injury or damage. Ryans v. Lowell, 197 N.J. Super. 266, 274 (App. Div. 1984). In order to state a claim for negligence, a plaintiff must first establish that a duty is owed to the plaintiff by a defendant. Strachan v. JFK Memorial Hospital, 109 N.J. 523, 529 (1988). The question of whether a duty exists is a matter of law properly decided by the Court, and is largely a question of fairness and policy. Wang v. Allstate Co., 125 N.J. 2, 15 (1991). If this Court finds no duty exists, there can be no action for negligence. Ryan, 197 N.J. Super. at 275.

A duty of care exists when an actor creates an unreasonable risk of foreseeable harm or when such a duty is judicially imposed by policy considerations. Griesenback v. Kutter v. Walker, 199 N.J. Super. 132, 136 (App. Div. 1985) cert. denied 101 N.J. 264 (1985). In order for a Court to find the existence of a duty, this Court must make a "value

judgment, based on an analysis of public policy, that the actor owed the injured party a duty of reasonable care." Kelly v. Gwinnell, 96 N.J. 538, 544 (1984). This value judgment requires a "weighing of the relationship of the parties, the nature of the risk, and the public interest in the proposed solution." Goldberg v. Housing Auth. of Newark, 38 N.J. 578, 583 (1962); Carvalho v. Toll Brothers and Developers, 143 N.J. 565 (1996).

In the instant case, there was no relationship between plaintiffs and defendants. Although it is alleged that defendants knew or should have known that Kohli was trading for third parties, there are no allegations that defendants had any contact with plaintiffs to solicit business or provide advice. Considering the absolute absence of a relationship between plaintiff and defendants, this Court cannot find that defendants' actions created an unreasonable risk of harm to plaintiffs or that the injury to plaintiffs was foreseeable in the instant case. See Riggs v. Schappell, 939 F.Supp. 321, 332 (D.N.J. 1996) (Finding that a clearing broker does not owe the customer of an introducing broker a "broad fiduciary duty" sufficient to support a negligence action under New Jersey law); Kolbeck v. LIT America, Inc, 923 F.Supp. 557 (S.D.N.Y. 1996) (Securities brokers do not owe a general duty of care or disclosure to the public simply because they are market professionals. A duty of care arises only when the broker does business with the plaintiff and then the duty of the broker is to attend to the plaintiff's business with care). Therefore, Count VIII of plaintiffs' Amended Complaint will be dismissed.

10. Count Nine: RICO, 18 U.S.C. § 1962(c) and § 1962(d)

In Count Nine, plaintiffs allege that the defendants violated the provisions of the Racketeer Influenced and Corrupt Organizations Act. 18 U.S.C. §§ 1961 et seq. Specifically, plaintiffs allege a violation of Section 1962(c) which provides in relevant part:

> It shall be unlawful for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly in the conduct of such enterprise's affairs through a pattern or practice of racketeering activity or collection of an unlawful debt.

18 U.S.C. § 1962(c). Section 1962(c) requires the plaintiff to plead the following: 1) the existence of an enterprise whose activities affect interstate commerce; 2) that defendants participated in the conduct of the affairs of the enterprise; and 3) that the participation took the form, at least in part, of racketeering activities. Plaintiffs must also plead that they were injured in their business or property by reason of a violation of § 1962(c).

Liability under § 1962(c) only attaches to persons who participate in the operation or management of the RICO enterprise. Reves v. Ernst & Young, 113 S.Ct. 1163, 1172-74 (1993). This means that § 1962(c) may not be imposed on one who merely "carries on" or "participates" in an enterprise, but rather, in order to be liable, "one must have some part in directing those affairs." Id. at 1168-70. The mere rendering of professional services does not constitute participation in the direction of the corporation to whom those services were provided. University of Maryland v. Peat, Marwick, Main, 996 F.2d 1534, 1539 (3d Cir. 1993).

"Simply because one provides goods or services that ultimately benefit the enterprise does not mean that one becomes liable under RICO as a result. There must be a nexus between the person and the conduct in the affairs of an enterprise. The operation or management test goes to that nexus." University of Maryland, 996 F.2d at 1539. "Outsiders" may be liable under § 1962(c) if they are "associated with" an enterprise and participate in the conduct of its affairs to the point that they in some way direct the enterprise. Reves, 507 U.S. at 185. Under this test, not even action involving some degree of decisionmaking constitutes participation in the affairs of an enterprise. University of Maryland, 996 F.2d at 1538.

Many courts faced with post-Reves § 1962(c) claims against outside professionals have agreed that providing important services to a racketeering enterprise is not the same as directing the affairs of the enterprise. See e.g. Azrielli v. Cohen Law Offices, 21 F.3d 512, 521-22 (2d Cir. 1994) (provision of legal services related to fraudulent real estate transaction was not management of the RICO enterprise conducting the fraudulent transaction); University of Maryland at Baltimore at Maryland v. Peat, Marwick, Main & Co., 996 F.2d 1534, 1539 (3d Cir. 1993) ("Simply because one provides goods or services that ultimately benefit the enterprise does not mean that one becomes liable under RICO as a result); Fidelity Federal Sav. & Loan Ass'n v. Felicetti, 830 F.Supp. 257, 260 (E.D. Pa. 1993) (even if appraiser's reports are "keystone" of enterprise's perpetration of fraud, appraiser cannot be liable under section 1962(c)); United States v. Oreto, 37 F.3d 739, 750 (1st Cir. 1994) (accountants in Reves were not liable because "while they were undeniably involved in the enterprise's decisions, they neither made those

decisions nor carried them out; in other words, the accountants were outside the chain of command), cert. denied 115 S.Ct. 1161 (1995); Baumer v. Pachl, 8 F.3d 1341, 1344 (9th Cir. 1993) (providing legal services to an enterprise did not satisfy "operation or management" test); Stone v. Kirk, 8 F.3d 1079, 1092 (6th Cir. 1993) (sales representative did not participate in "operation or management" of the enterprise).

Plaintiffs contend that defendants directly participated in the RICO enterprise by carrying the accounts of the Sigma Entities and by transacting the business of the Sigma entities through the clearing of commodity futures contracts and options transactions. Plaintiffs contend that within the customer account agreements between the Sigma entities and the defendant FCMs there is a clear and undisputable right to exercise control over the Sigma entities because the defendant FCMs had the right to limit or cease the trading of Sigma if the Sigma accounts failed to meet certain financial conditions or violated reasonable risk parameters. According to defendants, this inactivity is insufficient to qualify as "taking some part in directing the enterprise's affairs."

This Court cannot find that plaintiffs have adequately alleged that defendants participated in the operation or management of the Sigma entities. While plaintiffs have alleged that defendants' inaction allowed the Sigma entities to continue trading, there are no allegations that any of the defendants had decisionmaking authority at Sigma, or along with Kohli and Chandran was directing the fraudulent enterprise. Therefore, even reading plaintiffs' allegations as true, this Court finds that plaintiffs' have failed to state a claim upon which relief can be granted, and their RICO claim must be dismissed.

Plaintiffs have also alleged that defendants conspired to violate RICO in contravention of § 1962(d). Conspiracy to violate any other provision of § 1962 is a separate RICO violation. To plead conspiracy adequately, a plaintiff must set forth allegations that address the period of the conspiracy, the object of the conspiracy, and the certain actions of the alleged conspirators taken to achieve that purpose. Kalmanovitz v. G. Heileman Brewing Co., 595 F.Supp. 1385, 1400-1401 (D.Del. 1984) aff'd 769 F.2d 152 (3d Cir. 1985). A defendant must 'knowingly agree, to participate in the enterprise through a pattern of racketeering. United States v. Riccobene, 709 F.2d 214, 220-21 (3d Cir.) cert. denied 464 U.S. 849 (1983). Additional elements include agreement to commit predicate acts and knowledge that the acts were part of a pattern of racketeering activity. Shearin v. E.F. Hutton Group, Inc., 885 F.2d 1162, 1167 (3d Cir. 1989); Odesser v. Continental Bank, 676 F.Supp. 1305, 1312-1313 (E.D. Pa. 1987).

This Court notes that a § 1962(d) claim can exist in the absence of a viable claim under §1962(c). See United States v. Antar, 53 F.3d 568 (3d Cir. 1995); see e.g. United States v. Viola, 35 F. 3d 37, 43 (2d Cir. 1994) (a "RICO conspiracy charge is proven if the defendant embraced the objective of the alleged conspiracy and agreed to commit two predicate acts in furtherance thereof, irrespective of the fact the defendant did not participate in the operation or management of the enterprise). However, liability is limited to those who conspire to operate or manage an enterprise, and does not extend to those who conspire with someone who is operating or managing the enterprise. See Antar, 53 F.3d 568, 581 (3d Cir. 1995). In the instant case, plaintiffs have not alleged that defendants conspired to operate or manage the enterprise, but

merely that they conspired with the individuals who did so. Therefore, plaintiffs have failed to state a claim under § 1962(d) and this claim will be dismissed.

11. Count Ten: Fraud and Civil Conspiracy

In Count Ten, brought pursuant to New Jersey common law against defendants FCMs and FCM EMPLOYEES, plaintiffs assert claims of fraud and civil conspiracy. Plaintiffs contend that defendant FCMs and FCM EMPLOYEES breached their duties by aiding and abetting Kohli, Chandran and the Sigma Entities in their frauds and conspiring with them to commit these frauds or acting in concert with them in these frauds by concealing the true nature of their activities from plaintiffs. ¶ 212. Further, plaintiffs contend that defendant FCMs defrauded plaintiffs by intentionally creating the false public perception that the unregistered pool was large, profitable and legitimate and by failing to disclose material facts to plaintiffs. ¶ 213. With regard to their claim of conspiracy, plaintiffs contend that defendant FCMs conspired in combination with Kohli, Chandran and the Sigma Entities to commit criminal or unlawful acts including but not limited to conspiring to obtain funds from the plaintiff class members by misrepresentation or fraud and conspiracy to cover up the true nature of Kohli and Chandran's "Ponzi" scheme. ¶ 216.

Under New Jersey law, the elements of civil fraud are: 1) the making of a misrepresentation of material fact; 2) which is made with the knowledge of its falsity; 3) that plaintiffs rely upon to their detriment. Jewish Center of Sussex County v. Whale, 86 N.J. 619, 624-25 (1981). There can be no liability for misrepresentations based on failure to

disclose unless a duty to disclose exists. See Lightning Lube, Inc. v. Witco Corp., 4 F.3d 1153, 1185, 1187 (3d Cir. 1993). As this Court finds that there was no duty imposed upon defendants with regard to plaintiffs, this Court cannot find that the failure of defendants to disclose information it is alleged to have knowledge of constitutes fraud. Therefore, plaintiffs claim of fraud must be dismissed.

A civil conspiracy is "a combination of two or more persons acting in concert to commit an unlawful act or to commit a fanciful act by unlawful means, the principal element of which is an agreement between the parties to inflict a wrong or injury upon another, and an overt act that results in damage." Morgan v. Union County Board of Chosen Freeholders, 268 N.J. Super. 337, 364 (App. Div. 1993). "The gist of the claim is not the unlawful agreement, but the underlying wrong which, absent the conspiracy, would give a right of action." Id. In order to show civil conspiracy, an act must be committed by at least one of the co-conspirators towards the fulfillment of the conspiracy, and this action must cause some injury to the plaintiff. A conspiracy need not be proven directly, but rather can be inferred from the circumstances. A co-conspirator is liable for all of the acts of his fellow conspirator made in furtherance of the conspiracy. Morgan v. Union County Board of Chosen Freeholders, 268 N.J. Super. 337, 364-366 (App. Div. 1993). Proof of a conspiracy makes the conspirators jointly liable for the wrong and the resulting damages. Board of Education of the City of Asbury Park v. Hoek, 38 N.J. 213 (1962). As direct evidence of an unlawful agreement is rare, the Supreme Court has stated that "the question of whether an agreement exists should not be taken from the jury in a civil conspiracy case so long as there is a possibility that the jury can infer from the

circumstances [the alleged conspirators] had a meeting of the minds and thus reached an understanding to achieve the conspiracy's objectives." Addickes v. S.H. Kress, 398 U.S. 144, 158 (1970).

In the instant case Plaintiffs have failed to allege facts from which this Court could infer a meeting of the minds or an agreement to carry out the fraudulent scheme. Therefore, plaintiffs' claim for civil conspiracy must be dismissed.

12. Count Eleven: New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1, et seq.

In Count Eleven, plaintiffs assert a claim under the New Jersey Consumer Fraud Act against defendants FCMs and FCM EMPLOYEES. Plaintiffs contend that the named defendants have violated the New Jersey Consumer Fraud Act by allowing Kohli, Chandran and the Sigma Entities to trade commodities, futures contracts, commodity options and contracts for sale of commodities for future delivery, on behalf of non-Members of the NFA that are required to be registered with the CFTC, thereby causing the acts of Kohli, Chandran and the Sigma Entities to appear to be legal. Plaintiffs assert that defendants' acts constitute unfair or deceptive trade practices and are in violation of the New Jersey Consumer Fraud Act in that defendants knowingly concealed and suppressed the material fact that Kohli, Chandran and the Sigma Entities were not registered with the CFTC as an AP, a CPO or a CTA nor a member of the NFA, in connection With the sale of merchandise and that such actions are in violation of Federal and state statutes enacted in the public interest and therefore constitute a violation of the New Jersey Consumer Fraud Act. ¶221.

The New Jersey Consumer Fraud Act provides that:

> . . . [T]he knowing, concealment, suppression, or omission of any material fact with intent that others rely upon such concealment, suppression or omission in connection with the sale or advertisement of any merchandise or real estate . . . is declared to be an unlawful practice.

N.J.S.A. § 56:8-2 (1996). Merchandise is broadly defined as "any objects, wares, goods, commodities, services, or anything offered, directly or indirectly to the public for sale." N.J. Stat. Ann, tit. 56 § 8-1(c). The New Jersey Consumer Fraud Act is, as its name implies, designed to protect consumers from deceptive sales or advertising practices. Its broad language evidences "legislative concern over sharp practices and dealings in the marketing of merchandise and real estate whereby the consumer could be victimized by being lured into a purchase through fraudulent, deceptive or other similar kind of selling or advertising practice." Daaleman v. Elizabethtown Gas Co., 77 N.J. 267, 271 (1978).

The New Jersey Consumer Fraud Act does not apply to the sale of "securities". Bramblewood Investors, Ltd. v. C & G Assoc., 262 N.J. Super, 96, 109 n.6 (Law Div. 1992); In re Catanella, 583 F.Supp. 1388, 1441-44 (E.D. Pa. 1984). Part of the reason for such exclusion is the differentiation between professional or semi-professional services and traditional "consumer" services. In re Catanalla, 583 F.Supp. 1388 (1984) ("there is a distinction . . . between the policies underlying the protection of consumers in general and the

protection of investors in particular. . . . Securities fraud is qualitatively different from the archetypal installment credit sale scam where the uneducated are duped into buying inferior consumer goods at exorbitant prices. The rationale behind the Consumer Fraud Act is inapposite in the securities fraud area). Moreover, the very existence of a carefully drawn state securities law militates against the application of the Consumer Fraud Act to securities." Catanella, 583 F.Supp. at 1443.

Therefore, plaintiffs' claim based upon the Consumer Fraud Act is dismissed.

13. Rule 11 Sanctions

Defendants Saul Stone & Company LC, First Options of Chicago, Inc., Smith Barney, Inc, L.G., LC, GNI Incorporated, GNI Limited, Dean Witter Reynolds, Inc., ING (U.S.) Securities Future & Options, Inc. (d/b/a ING Futures & Options), Merrill Lynch. Pierce, Fenner & Smith, Inc., Prudential Securities, Incorporated, Rosenthal Collins Group, L.P. (f/k/a Rosenthal & Company), E.D. & F. Man International, Inc. and the National Futures Association ("NFA") have also moved for an Order sanctioning plaintiffs and their attorneys for asserting claims in violation of Fed. R. Civ. P. 11. Defendants have further moved for an award of their reasonable attorneys' fees and costs incurred as a result of the violation.

Defendants contend that despite repeated opportunities to withdraw or amend their complaint voluntarily, plaintiffs have persisted in their assertion of claims which are not well grounded in fact or supported by existing law or a good faith

modification of that law. Defendants further contend that this deliberate refusal to comply with Rule 11 warrants the application of monetary sanctions, including the payment by plaintiffs and their counsel of the reasonable fees and costs incurred by defendants. Defendants, "recognizing that the CFTC's brief on the issue represents a nonfrivolous argument for the extension, modification or reversal of the existing law under Rule 11" have withdrawn their motion for sanctions insofar as it relates to the Section 22 aiding and abetting claim brought on behalf of the plaintiffs. Defendants, however, continue to seek sanctions with regard to plaintiffs' claims of direct liability under Section 22, RICO and state claims, and claims against defendants GNI, Inc. and GNI Limited claiming that such claims are without basis in fact or law.

Pursuant to Fed. R.Civ. P. 11(b), attorneys and pro se litigants must comply with certain standards of propriety:

> (b) Representations to Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) a pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, --
>
> > (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;

> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified, are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

Where an attorney, law firm or litigant has failed to comply with Rule 11(b), the Court may, after notice and a reasonable opportunity to respond, impose sanctions. However, "[r]ule 11 is intended for only exceptional circumstances." Morristown Daily Record, Inc. v. Graphic Communications, Union Local 8N, 832 F.2d 31, 32 n. 1 (3d Cir. 1987). In deciding whether sanctions are appropriate, the Court should "avoid using the wisdom of hindsight and should test the signer's conduct by inquiring what was reasonable to believe at the time the pleading, motion or other paper was submitted." Auchmuty & Greenwald v. Holtzman, 775 F.2d 535, 540 (3d Cir. 1985).

> The Rule imposes an obligation on counsel and client analogous to the railroad crossing sign, "Stop, Look and Listen." It may be rephrased, "Stop, Think, Investigate and Research" before filing papers either to initiate a suit or to conduct the litigation. These obligations conform to those practices which responsible lawyers have always employed in vigorously representing their clients while recognizing the court's duty to serve the public efficiently.

Gaiardo v. Ethyl Corp., 835 F.2d 479, 483 (3d Cir. 1987). Rule 11 should not be utilized as a fee shifting device in order to avoid requiring each party to cover its own legal expenses. Id. at 483.

The Supreme Court has concluded that "the central purpose of Rule 11 is to deter baseless filing in district court and thus, consistent with the Rules Enabling Act's grant of authority, streamline the administration and procedure of the federal courts." Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 393 (1990). The reasonable inquiry element is measured by an objective standard of reasonableness under the circumstances. See Chambers v. NASCO, Inc., 501 U.S. 32, 47 (1991). Subjective good faith on the part of the attorney is insufficient to avoid sanctions.

The court must use its own discretion to set proper sanctions under Rule 11, which may or may not include attorney's fees. Doering v. Union County Bd. of Chosen Freeholders, 857 F.2d 191, 194 (3d Cir. 1988). Sanctions are imposed under Rule 11 only to the extent necessary to deter

unfounded claims. Doering, 857 F.2d at 194. The rule is not intended as a punishment. See id at 196. The court should impose the least sanction necessary to serve as an adequate deterrence. Id. at 194.

In the instant case, plaintiffs have advanced a number of claims which this Court has not found to be viable. However, the analysis required close defining of legal theory. This Court is not persuaded that the claims were so unreasonable as to warrant Rule 11 sanctions.

CONCLUSION

For the foregoing reasons, the various motions of defendants to dismiss plaintiffs' complaint are granted, defendants' motion for Rule 11 sanction is denied and this case is closed. An appropriate order is filed herewith.

Dated: 6/30/98

APPENDIX C

UNITED STATES OF AMERICA
Before the
COMMODITY TRADING COMMISSION

[Dated 1981]

In the Matter of the	)
Application of the National Futures	)
Association	)
	)

(Excerpts From)
ORDER GRANTING REGISTRATION AND APPROVING RULES

I. Introduction

The National Futures Association ("NFA") submitted an application to the Commodity Futures Trading Commission ("Commission") for registration as a registered futures association under Section 17 of the Commodity Exchange Act ("Act"), 7 U.S.C. §21 (Supp. III 1979), on March 16, 1981. The Commission published notice of the application in the Federal Register, requested public comment and announced the Commission's intention to hold a public hearing regarding

the application.[1] In recognition of their prior interest in the Commission's consideration of issues relating to registration of futures associations, the Commission also expressly solicited the views of the Securities and Exchange Commission ("SEC"), the Antitrust Division of the Department of Justice ("Justice"), and the National Association of Securities Dealers, Inc. ("NASD").[2]

On June 4, 1981, the Commission held the public hearing announced in the Federal Register notice. Twelve individuals representing various segments of the . . .

* * *

(Page 5)

. . . be compulsory for FCMs and their agents, CPOs, and CTAs. The rules do not explicitly compel such membership, but proposed Bylaw 1101 would prohibit NFA members from carrying accounts, accepting orders, or handling accounts for

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[1] 46 FR 23101 (April 23, 1981). The Commission initially afforded the public sixty days to submit comments, but upon request of a number of interested persons, the Commission extended the comment period to July 2, 1981. 46 FR 35140 (July 7, 1981). In considering NFA's application, the Commission also took into account views expressed in comment letters received after July 2, 1981.

[2] Letters dated April 22, 1981, from Theodore W. Urban, Deputy Director, Division of Trading and Markets, to George A. Fitzsimmons, Secretary, SEC; Stanley M. Gorinson, Chief, Special Regulated Industries Section, Justice; and Gordon Macklin, President, NASD.

or on behalf of any suspended or non-member of the NFA who is not a member of another registered futures association, unless such person is exempted from the provisions of Bylaw 1101 by the NFA Appeals Committee or by resolution of the NFA Board of Directors ("Board"). In addition, Bylaw 301 would require APs of FCMs to register with the NFA as "associates." Consequently, each step in the order-handling process leading to execution by a floor broker (floor brokers will not be subject to the compulsory membership provision) would have to be effected through an NFA member or a person subject to NFA regulation.[15]

The NFA will be governed by a forty-member Board.[16] Section 2 of Article VII describes the Board's composition as follows: (a) each exchange will select a director to serve as its representative, except that every contract market having more than 20 percent of the previous calendar year's volume on all exchanges will have two directors each;[17] (b) FCMs with more than 50 branch offices will be represented by a total of six directors, while FCMs

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[15] NFA has stated that the effectiveness of this provision rests upon the presumption that all contract markets will require their FCM members to join NFA. See the NFA Registration Statement ("Registration Statement") at 8 n. 1.

[16] Article VII; Bylaw 501.

[17] The total number of contract markets that may be represented on the Board has been limited to the current eleven. Should another board of trade apply for and receive designation as a contract market, the eleven contract markets with the greatest transaction volume would be represented on the Board.

with 16-50 branch offices will be allocated four directors, as will FCMs with fewer than 16 branch offices; (c) CPOs, CTAs and commercial members ("Industry Participants") will be represented by a total of ten directors -- two directors each for CPOs and . . .

* * *

(Pages 15-17)

submitted a revised version of its draft articles of incorporation on July 20, 1977, along with a revised "Points of Agreement" setting forth the organizing committee's intent.[53] The revised draft contained a modified manner for selecting a board of directors.

Justice subsequently commented on the informal proposal, expressing its opinion that NFA's mandatory membership requirement, in particular, posed an unconstitutional delegation of agency authority and was not, as required by Section 15 of the Act, the least anticompetitive means available to the Commission to achieve the objectives of the Act.[54] The Commission then afforded NFA an

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[53] Letter from Philip F. Johnson, then Counsel for the NFA organizing committee, to Richard E. Nathan, then Acting General Counsel, dated July 20, 1977.

[54] 7 U.S.C. §19 (1976). See In the Matter of the National Futures Association, Comments of October 7, 1977, from Justice to the Commission (hereinafter cited as "1977 Justice Comments").

opportunity to respond to Justice's comments.[55] In addition, the Public Interest Economic Center, under contract with the Commission, undertook a study of the competitive aspects of the futures trading industry and expressed some reservations about the NFA proposal which are discussed below.[56] The NFA draft application thereafter was not formally submitted to the Commission and, accordingly, the Commission deferred any further consideration of the NFA's draft proposal. The concerns which Justice raised were addressed explicitly by Congress in 1978.

C. 1978 Reauthorization: Section 17(m)

During the Commission's 1978 reauthorization hearings; subcommittees of both the House Committee on Agriculture and the Senate Committee on Agriculture, Nutrition and Forestry heard testimony from many witnesses expressing their opinion that a futures association should be created.[57] The Senate Subcommittee considered that:

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[55] Response of the National Futures Association to Objections to its Preliminary Proposal, January 31, 1978.

[56] See Jones, N. and Ferguson, A., Competition and Efficiency in the Commodity Futures Markets (May 1978). See also pp. 30-32 infra.

[57] See Hearings on H.R. 10285 Before the Subcommittee on Conservation and Credit of the House Committee on Agriculture, 95th Cong., 2d Sess. (pp. VIII-IX for summary of testimony) (1978) (hereinafter cited as "1978 House Hearings"); Hearings on the Reauthorization of the Commodity Futures Trading Commission Before the Subcommittee on Agricultural Research

> [t]he industry has worked to develop a regulatory organization which would apply to the CFTC for approval. . . . This title III organization is designed to regulate all FCM's taking over the responsibility in this area formerly carried out by the exchanges, whereby the exchanges will regulate all activities at the exchange level, such as floor trading practices, contract details, financial integrity of clearinghouse members, et cetera.
>
> Thus, the industry would be regulated through the exchanges concerning exchange operations, and through the title III organization concerning FCMs and their contacts with the public.[58]

During the Senate floor debate on the legislation, Senator Patrick J. Leahy stated that the proposed amendments to Title III were being offered in order:

> to speed the establishment of these associations and to allow them to assume some of the duties currently being conducted by the Commission.

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and General Legislation of the Senate Committee on Agriculture, Nutrition, and Forestry, 95th Cong., 2d Sess. pt. II at 12, 13, 26, 27, 29, 30, 47, 48, 50, 51, 68, 116, 119, 121, 122, 136, 137, 186, 190 and 191 (1978) (hereinafter cited as "1978 Senate Hearings").

[58] Testimony of David T. Johnston, then Vice President, E.F. Hutton Inc., 1978 Senate Hearings at 121.

> These associations could free Commission personnel to engage in other activities.[59]

Most significantly, the committees adopted new Section 17(m), which expressly allows the Commission to approve rules of a futures association that would make membership in at least one futures association mandatory for persons eligible for membership.[60] The House Committee commented that:

> [u]se of the authority of this amendment would be completely discretionary with the Commission. The committee was persuaded that such discretion may be useful to the Commission if it should decide that such a provision is necessary for an effective self-regulation program and is otherwise in the interest of the objectives of section 17.[61]

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[59] See 124 Cong. Rec. S10535 (daily ed. July 12, 1978). See also remarks of Rep. Foley, 124 Cong. Rec. H7206 (July 24, 1978); and S. Rep. No. 850, accompanying S.2391, 95th Cong., 2d Sess. 30 (1978).

[60] The Senate Committee's mandatory membership amendment to Section 17 would have granted the Commission the authority to approve mandatory membership rules of either a Title III association or a contract market for persons eligible for membership. See S. Rep. No. 850, 95th Cong., 2d Sess. 31 (1978).

[61] H.R. Rep. No. 1181, 95th Cong., 2d Sess. 20 (1978).

The Conference Committee of the Senate and House agreed to adopt the House amendment, thereby explicitly permitting the Commission to approve mandatory membership rules of any futures association. The conferees also adopted provisions that increased the limit on the amount in controversy in futures association customer arbitration proceedings to $15,000 and authorized the Commission to delegate to a registered association certain aspects of the Commission's registration functions for APs.[62]

D. Adoption of Part 170; The NFA Application

In furtherance of its statutory mandate under Section 17 of the Act, the Commission adopted, effective April 10, 1979, regulations governing applications for registration submitted under Title III and specifying standards with which such applications must comply.[63] The Commission's regulations expanded upon the . . .

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(Pages 19-21)

. . . implement. Rather, in seeking registration as currently structured and formulated, the NFA would commence operations with responsibility for certain core self-regulatory

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[62] See 124 Cong. Rec. H10685, H10687, H10691 (September 25, 1978).

[63] The Commission adopted Part 170 of its regulations (17 CFR Part 170 (1981)). See 44 FR 20649 (April 6, 1979), [1977-80 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶20,795. When proposing the registration standards, . . .

functions and thereafter, subject to further Commission review, evolve in a practical manner to fulfill additional objectives of the. Act and Commission regulations thereunder.

IV. Analysis of the NFA Application

The NFA application addresses each of the mandatory requirements for registration set forth in Section 17(b) of the Act and Part 170 of the Commission's regulations. The cumulative effect of the NFA's rules and the regulatory functions which it will assume, is to demonstrate that the Commission's registration of the NFA will benefit the public interest. The discussion which follows analyzes the nature of the public interest to be served by the NFA's registration and its specific compliance with each provision of Section 17(b) of the Act and the Commission's regulations thereunder.

A. Section 17(b) (1): Public Interest

Section 17(b)(1) prohibits the Commission from registering the NFA unless it is able to find that the NFA "is in the public interest and that it will be able to comply with the provisions of this section and the rules and regulations thereunder and to carry out the purposes of this section."[65] Commission regulations 170.1 and 170.9 reiterate the statutory standard and 170.9 in particular provides that an

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[65] 7 U.S.C. §21(b)(1) (1976).

applicant association must "conduct its affairs consistent with the public interest to be protected by the antitrust laws."[66]

In evaluating whether registration of the NFA would be in the public interest, the Commission considered whether a need for additional regulation of the commodities industry exists. Concluding that a regulatory gap exists and that coordination is lacking with respect to industry regulation of participants' financial responsibility and sales practices, the Commission then analyzed whether the role of a comprehensive futures association such as the NFA could serve the public interest by assuming self-regulatory responsibilities where a need has been identified. In this regard, the Commission examined the extent to which the NFA could more effectively or efficiently perform regulatory functions currently exercised by the Commission. In addition, the Commission considered the experience of the SEC with respect to its program to regulate broker-dealers that are not NASD or securities exchange members ("SECO program") as well as the SEC's reliance upon the NASD to perform certain self-regulatory functions similar to those proposed by the NFA.

1. Need for Effective Customer Protection

The NFA and others have asserted that the NFA's approach is the most practical and effective means to achieve a comprehensive self-regulatory program, and that its program is designed to fill a gap that currently exists in

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[66] Commission regulation 170.9, 17 CFR §170.9 (1981). See also pp. 77-80 infra.

commodities self-regulation.[67] The approach is not intended to replace the Commission's customer protection responsibilities, but to complement those duties by providing a vehicle through which commodity firms and professionals handling customer accounts will be subject to binding, uniform ethical and financial standards.[68]

The NFA approach will impose professional standards on industry participants not currently subject to self-regulatory ethical and financial rules. Many firms and individuals conducting customer-related commodities businesses are not regulated by a contract market and, therefore, not subject to the audit programs or disciplinary rules imposed on contract market members. For instance, 35 percent of the 376 FCMs registered with the Commission as of May 29, 1981, were not members of a contract market; neither were 99.24 percent of the 1,961 Commission-registered CTAs nor 98.83 percent of the 1,110 registered CPOs.[69] Further, the number of contract market member FCMs remained relatively constant (declining from 217 to

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[67] See Prepared Statements of Messrs. Morgan, Sander, Weiner and Magnussen at 5, 2-3, 2-3 and 6, 1-2, and 3-4, respectively. See also comment letters from the CME and Maduff.

[68] See, e.g., Prepared Statement of Mr. Melamed at 16.

[69] As of May 29, 1981, there were 32 firms that were registered as both CTAs and FCMs under the same name. Seventeen of those CTA/FCMs were not members of any contract market. Similarly, there were-19 CPOs that were also registered as FCMs, and 13 of those dual registrants were not contract market members.

205) during the period of August 1979 through. August 1980, while the number of FCMs which were not members of any contract market increased by approximately 40 percent (from 108 to 149).[70]

a. Financial Monitoring

Those FCMs which are not regulated by a contract market have been the cause of disproportionate compliance problems that might have been avoided . . .

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[70] In the ten years since 1970, the average volume of funds in segregation per firm (exchange member and non-exchange member) increased 4,000 percent from $.2 million in 1970 to $8.7 million in 1980, as shown in the following chart:

YEAR	AVERAGE FCM SEGREGATION	$ CHANGE	% CHANGE FROM PRECEDING YEAR
1970 *	$ 213,517		
1971 *	459,209	$ 245,692	115%
1976 *	2,105,809	1,646,600	359%
1979	4,950,000	2,844,191	135%
1980	8,737,286	3,787,286	77%

* See 42 FR 27167 (May 26, 1977).

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(Pages 29-32)

. . . ever, would be jeopardized if the NFA did not have provisions which, in effect, compel NFA membership by industry participants.

While the Commission has statutory discretion to register a futures association which requires membership by all potential regulatees, it also has authority to regulate those persons and firms that do not wish to be members of any voluntary futures association.[94] Thus, the Commission itself could directly impose and enforce business conduct and financial standards on those industry participants transacting customer business that are not association members. The Commission believes, however, that this approach would be less effective than a self-regulatory approach and that it would restrict the time which the Commission and its staff could devote to other statutory responsibilities that the Commission must fulfill, including those noted above.[95] The Commission believes, therefore, that the NFA approach should be a more effective method of ensuring adequate customer protection and offers the means to provide a level of customer protection responsive to the needs identified above. Moreover, in light of the NFA proposal and the clear statutory mandate favoring self-regulation by a registered futures association, the

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[94] See 7 U.S.C. §§21(d) and (e) (1976).

[95] See Prepared Statements of Messrs. Melamed, Morgan, Isaacson, Siebens and Weiner at 13-14, 11-12, 3, 5, and 2, respectively. See also comment letters from the CME, NAFTA, and Thomte.

Commission believes its reliance solely on direct Commission regulation of potential NFA members would be inappropriate.

In this regard, the Commission expects, that, as the NFA implements its regulatory programs, the Commission will be able to reallocate portions of its staff resources from the direct auditing functions which it now performs to other priorities (e.g., oversight of the exchange-traded options pilot program, greater scrutiny of existing self-regulatory programs, review of contract market rule proposals and applications for designation) and to more vigilant enforcement against all fraudulent activities, whether conducted on or off the commodity exchanges. The Commission believes that the direct regulation of retail sales practices and financial activities by both the Commission and a futures association necessarily would result in duplicative regulatory efforts.[96] It would result neither in cost efficiencies nor allow the Commission's staff the necessary time to develop other Commission programs that could enhance fair, competitive and efficient commodity futures trading.[97]

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[96] To provide biennial reviews of retail sales activities of every FCM, CPO and CTA, it is projected that the Commission would need to place at least 40 additional auditors into the regional field offices and increase its Washington staff by six attorneys and supervisors. The Commission, however, has no realistic expectation that such additional resources might be made available to it for these purposes.

[97] Justice also questioned in its comments whether an industry-wide insurance program might be a more effective means of providing customer protection against industry participant financial and sales practice abuses. Justice comments at 28. The

b. Complsory Contract Market Membership

The Commission also has considered whether the present structure of commodity self-regulation is effective to correct retail sales abuses.[98] In particular, the Commission examined whether it should require the contract markets to undertake the direct regulation of all FCMs, CPOs and CTAs by compelling all industry participants conducting customer business to join a contract market. The Commission considered this alternative in light of a 1978 study by the Public Interest Economic Center, which concluded that a superior alternative to registering a compulsory membership futures association would be to require all participants transacting customer business to join a contract market.[99] The Commission believes, however, that such an approach would

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Commission believes, however, that the value of such an insurance program as an alternative to self-regulation is questionable. In this regard, the Commission agrees with the NFA's observation that the NFA's program "is intended as a preventative program, unlike insurance, for example, which only comes into play after a loss occurs." Response III at 11. Moreover, the NFA also raises valid concerns as to whether "insurance premiums, absent an organization such as NFA, could be sufficiently low for smaller FCNs so as not to be a serious burden on competition." Id.

[98] See, e.g., Prepared Statement of Mr. Morgan at 5. Cf. Justice letter at 3-4, in which Justice asserts that the existing regulatory structure is adequate to regulate the industry and maximize consumer welfare.

[99] See Competition and Efficiency in the Commodity Futures Markets at 304-306.

be impractical, less effective and could impose significant competitive burdens on industry participants.

The Commission notes that the contract markets have not been inclined to expand their self-regulatory functions to include industry participants otherwise subject to what have been the traditional areas of contract market self-regulation. Moreover, to realize programs comparable to that proposed by the NFA, each contract market would have to develop programs for conducting retail sales audits of its members and routinely conduct such audits.[100] In connection with such programs, the contract markets would have to adopt and enforce more extensive rules relating to customer protection. The contract markets also would be required to regulate new categories of industry participants -- CPOs and CTAs -- in which the exchanges have had no prior direct regulatory experience. The responsibility to review contract markets' multiple rules and programs would impose a more time-consuming burden on the Commission than registering one or more associations whose principal purposes are to regulate the retail activities of specified categories of members.

Finally, the contract market customer protection rules that currently exist and which might be adoptee by each contract market could vary from exchange to exchange. Those industry participants that are members of two or more contract markets would often face conflicting exchange rules governing their customer-related activities as well as

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[100] See, p. 23 supra.

duplicative self-regulatory burdens.[101] By granting the NFA (or other futures associations) responsibility to regulate the retail sale practices and financial responsibility of specific categories of commodity firms and professionals directly, the Commission believes that the NFA will not only reduce conflicting and duplicative regulatory burdens on industry participants, but will also allow the Commission and the contract markets to reallocate more efficiently their resources to other regulatory programs.

c. Benefits of Self-Regulation by a Registered Futures Association

The Commission believes that its reliance upon the self-regulatory approach of a futures association will enable the industry to consolidate the expertise and experience of various industry segments, thereby allowing NFA readily to identify and solve industry regulatory problems. The opportunity for members to share their knowledge of developing sales practice or financial problems with a common self-regulator should encourage a response to such problems before they require Commission intervention. In this regard, the NFA will impose early warning financial reporting requirements on FCMs that are not members of any contract market. Thus, each FCM must notify, in addition to the Commission, either the NFA or its affiliated designated self-regulatory organization ("DSRO") (i.e., a . . .

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[101] Prepared Statements of Messrs. Melamed, Sandner, Stotier and Weiner at 8, 4, 2 and 2, respectively. See also comment letters from A.G. Becket, the CME and Bache.

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. . . the expense of maintaining separate arbitration facilities.[210] Moreover, by providing customers with an additional forum for the resolution of their commodity claims, the Commission anticipates that customers' reliance upon the Commission's reparation proceedings may be reduced and the pending backlog of such cases alleviated.

H. Section 17(m): Compulsory Membership

Section 17(m) authorizes the Commission to approve futures association rules requiring -- whether directly or indirectly -- all eligible persons to become members of at least one registered futures association if such a requirement is necessary or appropriate to achieve the purposes of the Act.[211] Moreover, the Commission may make that determination and give its approval notwithstanding any other provision of law. As previously mentioned,[212] the NFA has proposed such a compulsory membership requirement with respect to Commission registered FCMs, CPOs, CTAs and agents of FCMs.[213] In the NFA's case, the compulsory membership

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[210] See Prepared Statement of Mr. Magnussen at 7.

[211] 7 U.S.C. §21(m) (Supp. III 1979).

[212] See pp. 4-5 supra.

[213] In addition, APs affiliated with a member FCM or agent must themselves register with or be members of the NFA. Bylaw 301(a).

requirement is indirect. Once joining the NFA, members would be prohibited from engaging in any custcmer-related business with, or on behalf of, any non-member (or suspended member) FCM, CPO, CTA, or agent that is neither a member of another registered futures association nor otherwise exempted from this prohibition.[214]

The issue concerning the Commission's authority to approve rules compelling membership in a futures association surfaced in 1977, when the NFA put forward its proposed approach to ensure the comprehensive effectiveness of its regulatory programs. The NFA proposed to prohibit NFA members from handling customer business for any firm not also a member of NFA,[215] thereby assuring its jurisdiction over all industry participants toward whom the NFA's programs were directed. Justice asserted at that time, however, that not only did Congress not intend Section 17 to infer compulsory membership, but also such a membership requirement was unconstitutional under the Fifth Amendment[216] and inconsistent with antitrust law. Subsection

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[214] Bylaw 1101. See also Article III, Section l(f).

[215] See letter from Mr. Johnson to Commissioner Dunn, dated January 31, 1977, with an accompanying memorandum dated January 20, 1977 from Mr. Johnson to the NFA organizing committee.

[216] See the 1977 Justice comment letter. In light of the adoption of Section 17(m) of the Act, Justice apparently no longer contends that a compulsory membership requirement would be unconstitutional. See Comment letter from Justice. In 1977, Justice relied on several Depression-era cases that involved statutes

(m) was added to Section 17 by the Futures Trading Act of 1978[217] to settle the question whether the Commission has the authority to register a futures association which provides for mandatory membership.

In enacting current Section 17(m), Congress took note that:

> This objective [of effective self-regulation] would be frustrated if futures industry professionals were free to discontinue their membership in the relevant association or associations when their own acts and practices came under scrutiny or investigation -- since a

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which the Supreme Court held to be unconstitutional delegations of legislative authority. See, e.g., Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935), which struck down a statutory provision permitting the President to approve a code of regulation proposed by a trade association for all persons engaged in the interstate buying and selling of live poultry. Since 1935, however, Congress enacted, and the Supreme Court has upheld, statutes granting greater government oversight of private association activities. See, e.g., Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381 (1940). See also Federal Power Commission v. New England Power Co., 415 U.S. 345, 352-53 (1974): "The notion that the Constitution narrowly confines the power of Congress to delegate authority to administrative agencies, which was briefly in vogue in the 1930's, has been virtually abandoned-by the Court for all practical purposes. . . ." (Marshall, J. concurring).

[217] Futures Trading Act of 1978, Pub. L. No. 95-405, 92 Stat. 865, amending 7 U.S.C. §21 (1976).

> title III association could not investigate, discipline, or impose corrective sanctions on non-member persons and firms.[218]

Congress thus affirmatively rejected the arguments against a mandatory approach to futures association membership. Instead, Congress expressly authorized the Commission, in its discretion, to approve requirements that directly or indirectly mandate membership in futures associations in order to prevent the associations inability to enforce their standards. Then introducing the 1978 amendment, Rep. Foley stated that:

> [a]t the present time there are industry participants operating largely beyond exchange supervision which are increasing in number. Regulation of any such persons could be achieved through expansion of Commission activities or, instead, through registration of one or more futures associations which would provide a self-regulatory program under Commission oversight. The committee has left the determination of that issue to the Commission. It has, however, included an amendment which provides expressly that the Commission may approve rules for any futures association or associations that would require persons eligible for membership to become members of at least one such association, upon a determination by the Commission that such

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[218] S. Rep. No. 650, 95th Cong., 2d Sess. 31 (1978).

> rules and regulations are appropriate to achieve the purposes and objectives of the Act. Use of the authority of this amendment would be completely discretionary with the Commission.[219]

Thus, there is no longer any question that the Commission may, in registering a futures association, entertain and approve a proposal that would, in effect, mandate membership in the association.

The NFA proposal focuses on those members involved in the flow of customer orders (i.e., FCMs and their agents, CPOs and CTAs, but not floor brokers or floor traders). It is likely that most' if not all industry participants handling customer accounts will seek to join the NFA, either voluntarily, under contract market requirement or in order to do business with NFA members -- thus the compulsory effect of the prohibition. Although those not joining the NFA will not be restricted from conducting business with other non-members, the need to use contract market members for order execution services on each of the contract markets will, for all practical purposes, make non-NFA membership highly unlikely.[220]

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[219] Remarks of Rep. Foley, 124 Cong. Rec. 7206 (daily ed. July 24, 1978) (emphasis supplied). See also 1978 House Conference Report at 26-27.

[220] NFA intends to to urge all the contract markets, which themselves are expected all to be NFA members, to require their own members to join NFA. See Prepared Statement of Mr. Melamed at 19. The Commission recognizes, however, that it is

The Commission also notes that the prohibition will not be effective immediately. Rather, it will be imposed in conjunction with the phase-in of corresponding regulatory programs.[221] For example, FCM members will not be prohibited from dealing with non-member FCMs until the FCM membership and surveillance programs are in operation.[222] Accordingly, at no time will any person be subject to the prohibition against order acceptance unless the person has become an NFA member and the NFA has adopted and implemented a regulatory program with respect to that person's category of membership.

Having considered the record before it, and, in particular, the significant public interest benefits which will be realized through registration of the NFA and implementation of its self-regulatory programs, the Commission believes that NFA's membership requirement is fully appropriate to achieve NFA's objectives and the purposes and objectives of the Act. Requiring membership in a registered futures association is an essential factor in providing the effective, industry-wide customer protection that the NFA proposes. If membership were purely voluntary, those engaging in abusive practices could evade self-regulatory compliance and sanctions simply by not joining, or by resigning from, the NFA or any comparable

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not necessary that all contract markets require their memberships, to join NFA in order for the prohibition to result in virtually industry-wide NFA membership.

[221] See Response II at 4. See also p. 8 supra.

[222] Id.

organization. Effective self-regulation will, in turn, reduce the Commission's (and thus the taxpayers') increasing and costly burden to monitor the activities of the various, professionals not subject to appropriate industry regulation and to enforce compliance under the Act.

V. Section 15 Considerations

Under Section 15 of the Act, the Commission must "consider the public interest to be protected by the antitrust laws and . . . endeavor to take the least anticompetitive means" to achieve the objectives and policies of the Act in approving bylaws and rules of registered futures associations established pursuant to Section 17.[223] Thus, in reviewing the NFA's application, the has balanced the potential anticompetitive effects of the NFA's requirements and procedures, the interests to be protected by the antitrust laws, and the regulatory benefits to be derived from this proposal. The Commission is not required, however, to choose the least anticompetitive means in acting upon the NFA's application. Rather, given the Commission's statutory-responsibilities and the complexities of the commodities industry, it is incumbent upon the Commission to give due weight to the regulatory consequences of NFA registration and the interests of self-regulation.[224]

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[223] 7 U.S.C. §19 (1976).

[224] The Supreme Court has held that simple antitrust enforcement cannot be compared to the ccmplex duties of an agency that has pervasive regulatory authority. See, e.g., Gordon v. New York Stock Exchange, 422 U.S. 659 (1975). The Supreme Court has also held that public regulatory activities are not subject

In addition, the Commission notes that possible inconsistencies with antitrust law need not prevent the Commission from approving rules that, in effect, serve to compel membership in a futures association. Indeed, Section 17(m) of the Act permits the Commission to approve ccmpulsory membership rules that are necessary or appropriate to achieve the purposes and objectives of the Act notwithstanding any other provision of law. The Commission nevertheless has examined NFA's application in light of the possibility that its compulsory membership requirement may act as a disincentive to competition.

The ramifications of not registering the NFA must be considered together with any anticompetitive implications which the proposal may raise. As previously discussed, the commodities industry in general does not currently afford an adequate level of self-regulatory customer protection and, where self-regulators have adopted customer protection rules, there is a lack of uniformity in the standards and procedures provided.[225] For example, while contract markets impose

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to the same competitive requirements applicable to private commercial conduct. See, e.g., Silver v. New York Stock Exchange, 373 U.S. 341 (1963), where the Supreme Court noted that when there is direct agency review, the antitrust laws will sustain self-regulatory activity meeting a "rule of reason" standard rather than a per se test. Id. at 358, n. 12. In United States v. National Association of Securities Dealers, Inc., 422 U.S. 694 (1974), the Supreme court exempted NASD restrictions from antitrust attack because they were subject to SEC review (citing Silver).

[225] See pp. 23 and 32 supra.

minimum financial requirements on, and conduct financial audits of, their members, they rarely, if ever, intercede regarding retail sales practices. The need for industry participants to comply with multiple, conflicting regulations in itself raises barriers to free and open competition. To the extent that the NFA application raises anticcmpetitive concerns, including its provision for compulsory membership, the Commission believes that the potential for the NFA to implement a comprehensive regulatory scheme, including the prevention or elimination of anticcmpetitive and conflicting contract market regulations, will serve the public interest and clearly outweigh any anticompetitive effects.

Moreover, the Commission does not believe that regulation of industry participants is, per se, an impediment to the free and open function of the market. On the contrary, as the NFA assumes responsibility for sales practice and financial regulation and related audits of its members, the Commission believes that the NFA may relieve the contract markets of responsibility to devote substantial resources to these areas, as well as to other regulatory areas where the NFA assumes a central regulatory role (e.g., arbitration of customer grievances). In this manner, the contract markets should have available greater resources to devote to the development of new products, self-regulation of their individual trading facilities, and the development of more efficient means of handling and executing orders. The Commission strongly believes that the availability of greater resources for these purposes will foster inter-market competition.[226] Moreover, the NFA's assumption of

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[226] Similarly, Commission establishment, surveillance and enforcement of effective industry-wide measures would require the

regulatory responsibility with respect to sales practices, and financial protection -- regulatory areas where inter-market competition to provide the least burdensome regulatory environment could lead to inadequate customer protection -- should assist the industry in establishing broadly based minimal standards in these areas and thereby avoid any potential adverse consequences of competition.

In conclusion, the Commission has considered the potential anti-competitive effects of the NFA proposals as well as the benefits to be derived, particularly in light of the Commission's other statutory responsibilities and resources. The Commission has found NFA's proposals to be in the public interest and the compulsory membership aspect to be fully, appropriate under the Act. Moreover, the Commission believes that the NFA's regulatory approach will strengthen the industry's integrity and foster competition. Accordingly, the Commission believes that the regulatory and public interest advantages expected to flow from registration of the NFA outweigh any potential anticcompetitive consequences.

VI. Conclusions and Findings

The NFA has submitted an application for a viable futures, association whose registration will be in the public interest. While the proposal as submitted does not provide for immediate implementation of the NFA's regulatory functions, the regulatory framework set forth in the application meets the

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Commission to redirect its limited resources and, consequently, jeopardize other Commission programs that could foster efficient, competitive and fair commodities markets.

standards established by Section 17 of the Act and Part 170 of the Commission's regulations.

As the NFA develops its regulatory programs and related rules, final implementation of such programs and rules will be subject to the review requirement of Section 17(j) of the Act.[227] Thus, the Commission's role with respect to the NFA will be an ongoing one. Additionally, the Commission will carefully monitor other aspect s of the NFA's rules which have raised concerns to determine whether in operation, as well as has been presented by the NFA, they will conform to the statutory standards.

The Commission has carefully studied the application and supplemental letters submitted by the NFA, written comment letters from the public and the testimony presented at the June 4, 1981 hearing. From this analysis, the Commission concludes that the NFA has demonstrated its ability to comply with Section 17 of the Act and Part 170 of the regulations, that it will promote fair and open competition among its members and otherwise further the purposes of the Act, and that it appears able to conduct its affairs consistent with the public interest to be protected by the antitrust laws. On this basis, the Commission is able to conclude that the NFA has met all of the requirements for registration set forth in the Act and the Commission's regulations thereunder, particularly those set forth in Section 17 and Part 170 thereunder.

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[227] 7 U.S.C. §21(j)(1976).

Accordingly, the Commission hereby orders that the registration of the National Futures Association is granted and that the Articles, Bylaws, Compliance Rules, Code of Arbitration and Financial Requirements contained in its Registration Statement are approved.

Issued in Washington, D.C., this 22nd day of September 1981 by the Commission (Commissioners Dunn, Gartner and Stone; Chairman Johnson did not participate).

/s/_____
Jane K. Stuckey
Secretary of the Commission

APPENDIX D

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

[Dated March 30, 1998]

Nos. 97-1975 and 97-1976

GLENN DAMATO, DEBORAH DAMATO, ANN DE LA GARZA, et al., *Plaintiff's-Appellants*,	)
v.	)
MERRILL LYNCH, PIERCE, FENNER & SMITH, INCORPORATED, JOHN HERMANSON, FIRST COMMERCIAL FINANCIAL GROUP, INCORPORATED, et al., *Defendants-Appellees*.	)

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division
Nos. 94 C 3041 and 94 C 3143
The Honorable lames C. Holderman, Judge Presiding

BRIEF OF COMMODITY FUTURES TRADING COMMISSION AMICUS CURIAE

INTEREST OF THE COMMODITY FUTURES TRADING COMMISSION

The Commodity Futures Trading Commission ("CFTC") is the independent federal agency created by Congress in 1974 to administer and enforce the Commodity Exchange Act ("CEA"), 7 U.S.C. § 1, et seq. The CEA provides an exclusive and comprehensive regulatory scheme for regulation of commodity futures and commodity options transactions. Implicit in the CFTC's statutory mandate is its responsibility to ensure that the provisions of thc CEA are interpreted in a manner consistent with Congressional purposes and sound public policy.

By order dated February 13, 1998, this Court invited the CFTC to submit a brief amicus curiae in this appeal. The Court asked the CFTC to address the circumstances under which §22 (a) of the CEA, 7 U.S.C. § 25(a), creates a private cause of action against defendants who aid and abet persons violating that section.[1] In that regard, the Court directed the CFTC's attention to two district court cases within the Seventh Circuit which conflict with respect to that issue. These cases are In re Lake States Commodities, Inc., 936 F. Supp. 1461, 1466-68 (N.D. Ill. 1996) and In re ContiCommodity Serv. Inc., Sec. Litig., 733 F. Supp. 1555, 1567 (N.D. I11. 1990), rev'd on other grounds, sub nom. Brown v. United States, 976 F.2d 1104 (7th Cir. 1992).

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[1] For purposes of this brief, after the initial reference to a CEA provision, it will be referred to subsequently by the CEA's internal section numbering rather than to its numeration in the United States Code.

ISSUE PRESENTED FOR REVIEW

Does the private right of action for aiding and abetting that is provided for under § 22(a) of the CEA apply to persons who "aid [and] abet" a violation of § 22(a), even if such aiders and abettors do not independently satisfy the requirements of subsections (A) through (D) of the statute?

NATURE OF THE CASE

The CFTC, as amicus curiae, adopts no particular version of the facts and takes no position as to which party should ultimately prevail on this appeal. Instead, the CFTC's concern is that the relevant statutory provision be properly interpreted and applied. Accordingly, this brief will confine itself to the legal question raised by the Court.

ARGUMENT

I. Introduction

Section 22(a)(1) provides:

> Any person . . . who violates this Act or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this Act shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person–

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of–

(i) an option subject to section 4c of this Act (other then an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 19 of this Act; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a

> manipulation of the price of any such contract or the price of the commodity underlying such contract.

Section 22(a) of the CEA provides an express private right of action for damages resulting from substantive violations of the Act. It identifies the persons potentially liable for damages as "any person who" violates the CEA or "who willfully aids, abets, counsels, induces, or procures the commission of a violation of this Act." The statute also defines and limits the universe of plaintiffs who have standing to sue for damages. See Indemnified Capital Investments, SA. v. R. J. O'Brien & Assoc,. Inc., 12 F.3d 1406, 1409 (7th Cir. 1993) (holding that, to establish standing, the "injury in fact" must be directly to the plaintiff). In subsections (A) through (D), § 22(a) also limits the damages recovered under the private right of action to those resulting certain specified transactions. Those transactions include instances in which the plaintiff received trading advice or purchased futures contracts, commodity options or an interest in a commodity pool from "such person[s]" liable under the Section.

The subject of this brief is the applicability of the "such person[s]" language contained in subsection (A) through (D) of § 22(a) to aiders and abettors. Specifically, this case raises the question whether the aider or abettor must have provided trading advice or sold futures, options or a pool interest directly to the plaintiff under § 22. As this Court is aware, this issue is the subject of conflicting opinions within this circuit.

The district court below ruled that plaintiffs-participants in a commodity pool[2] -- were precluded as a matter of law from stating claims of fraud pursuant to § 22(a)(1)(C)(iii) against First Commercial Financial Group, Incorporated, a futures commission merchant ("FCM")[3] that was alleged to have aided and abetted the persons who sold the commodity pool interests to the plaintiffs. Damato, et al. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al., 878 F.Supp. 1156 (N.D. Ill. 1995). Relying on the reference to "such persons" in subsections (A) through (D), the district court held that "the only persons subject to a private right of action under § 22(a)(1)(C)(iii) of the CEA are the persons who sold or took orders for interests in the commodity pool." Id. at 1161.

The district court decision was consistent with the ruling in In re Lake States Commodities, Inc., supra. The Lake States court found that under the "plain language" of § 22(a), a plaintiff must demonstrate that a defendant is one of the "such person[s]" listed in § 22(a)(1)(A)-(D) in order to hold the defendant liable under the CEA. 936 F. Supp. at

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[2] A "commodity pool" is an investment trust, syndicate or similar form of enterprise operated for the purpose of trading commodity futures or option contracts. CFTC Glossary, pg. 9 (CFTC 1997).

[3] A "futures commission merchant" is an entity or person engaged in soliciting or accepting orders for the purchase or sale of any commodity for future delivery who, in that connection, accepts money or extends credit to margin, guarantee or secure any trades or contracts that result therefrom. CEA § 1a(12), 7 U.S.C. § 2.

1467. Applying those provisions to the facts, the court stated that unless the putative defendant FCM sold interests in the commodity pool to the plaintiffs, or accepted orders for such purposes, no cause of action under § 22(a) would lie. Id.

The court in Lake States declined to borrow the broad definition of aiding and abetting in § 13(a) of the CEA, 7 U.S.C. § 13c(a), finding that § 13(a) empowers the CFTC to bring judicial, as well as administrative, actions against aiders and abettors of § 22(a) violations. Id. at 1467-68. The court also made clear that, while it recognized that § 13(a) was amended in 1983 to remove language that limited its applicability to administrative proceedings, in its view that change did not override the express provision of§ 22(a)(2), 7 U.S.C. § 25(a)(2) that states that § 22 provides the "exclusive remedies [sic] under this Act available to any person who sustains loss as a result of any alleged violation of this Act." Id. The court in Lake States dismissed the CEA claims against the aiding and abetting FCM, concluding that the plaintiffs had failed to allege that it was directly involved in any of the acts proscribed in § 22(a)(1)(A)-(D). Id. at 1468.

In contrast, the district court in In re ContiCommodity Servs. Inc., Sec. Lit., supra, reached a different conclusion. ContiCommodity involved a challenge to the legal sufficiency of customers' claims against Continental Grain Company ("Continental"), the parent company of an FCM, and individual defendants associated with ContiCommodity Services, Inc. ("Conti"), the FCM, for the alleged unauthorized trading and wrongful closeout of the customers' futures positions.

Defendants argued in that case that since neither Continental nor the Conti individual defendants sold futures contracts to the plaintiffs, they were not "such person[s]" within the meaning of § 22(a)(1)(A)-(D) and thus could not be liable under that Section. The district court rejected that argument concluding that § 13(a), the CEA's general aiding and abetting provision. "enables an injured party to bring a court suit against an aider and abetter, inducer, combiner, etc. who was not the 'such person' under § 22(a)(1)(A)-(D)." 733 F. Supp at 1567. Accordingly, the district court held that the customers could state claims against Continental and the Conti individual defendants--the alleged aiders and abettors--under § 22(a). Id.

II. A Plaintifff Who Alleges That A Defendant Aided And Abetted One Of "Such Person[s]" Specified In § 22(a)(1) May State A Private Cause Of Action For Damages Against That Aider And Abettor Under § 22(a)(1).

Section 22, the express private right of action provision of the CEA, was added to the CEA by Section 235 of the Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294, 2322-24. Discussing the express private right of action that was embodied in the bill, the House Agriculture Committee stated that it was "of the view that the right of an aggrieved person to sue a violator of the Act is critical to protection of the public and fundamental to maintaining the credibility of the futures market." H.P. Rep. No. 565, Part 1, 2d Sess. at 56-57 (1982). The legislative history of § 22 confirms that its passage was intended to resolve questions left open by the Supreme Court's decision in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353

(1982), which recognized a private right of action for violations of certain provisions of the CEA. H.R. Conf. Rep. No. 954, 9th Cong., 2d Sess. at 53. The bill was also designed to eliminate ambiguity concerning private causes of action under the CEA. Id. at 51-53.

Consistent with this purpose to authorize private actions against violators of the CEA, 22(a) provides broadly for the liability of "[a]ny person . . . who violates this Act," so long as the damages sued for are "actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person." Thus, the limitations on liability that are contained in § 22(a) are directed toward questions of causation and standing and were intended only to ensure that the "violation" for which suit is brought is both causally and transactionally connected to actual damages suffered by the putative plaintiff.

Where such a connection exists between a plaintiff's damages and a violation by a primary violator, the statutory language supports the conclusion that an aider and abettor of the primary violator is liable. Section 22(a)(1) requires only that the damages be "caused by such violation to" one of the listed categories of persons and that the damages result from one of the "transactions" delineated in subparagraphs (A)-(D). Importantly, § 22(a)(1) does not provide that damages to one of the listed categories of persons must be caused by the person charged under § 22(a)(1), but only that they must be "caused by such violation" (emphasis supplied).

By definition, an aider and abettor knowingly contributes to a primary wrongdoer's violation, rather than committing an independent violation of his or her own. See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 176 (1994) ("[A]iding and abetting liability extends beyond persons who engage, even indirectly, in a proscribed activity, aiding and abetting liability reaches persons who do not engage in the proscribed activities at all, but who give a degree of aid to chose who do."). If the primary violator's wrongdoing satisfies the requirements of subparagraphs (A) through (D) of § 22(a)(1), then the plaintiff's damages are "caused by such violation," irrespective of whether the aider and abettor independently would satisfy the requirements of subparagraphs (A) through (D).

Indeed, requiring that the aider and abettor be "such person" within the meaning of subparagraphs (A) through (D) renders § 22(a) internally inconsistent and does violence to the clear intent of § 22. As indicated above, § 22(a)(1)(A)-(D) defines the persons who are appropriate plaintiffs under the CEA. It also sets forth the damages that may be recovered in a private right of action. It limits recovery to damages caused by the violation and "resulting from one or more of the transactions referred to in subparagraphs (A) through (D)." If "such person" under subparagraphs (A) through (D) referred to in the aider and abettor (i.e., if the aider and abettor were required to have the direct relationship with the plaintiff], then the only damages recoverable would be those resulting from the transaction between the aider and abettor and the plaintiff. This is nonsensical, because the plaintiff's damages result not from the act of the aider and abettor in providing trading advice or selling futures, options

or pool interests to the plaintiff, but from the violation itself by the primary violator. It is also clearly inconsistent with the language of § 22(a)(1) which requires that the damages be "caused by such violation." In other words, it is the violation of the CEA by the primary violator that gives rise to the damages recoverable under § 22. Thus, for the language of § 22 to make sense, "such person" in subparagraphs (A) through (D) must refer to the primary violator and not the aider and abettor.

In sum, the plain language of § 22(a) creates liability for an aider and abettor if (i) he or she assists in a violation of the Act, (ii) the plaintiffs' damages are caused by that underlying violation and (iii) the damages result from one of the transactions set forth in subparagraphs (A)-(D). There is no independent requirement that both the primary violator and the aider and abettor directly with the plaintiff.

This conclusion is reinforced when one considers § 22(a) in light of general principles of aiding and abetting, which it is reasonable to assume were intended by Congress to be operative in the context of § 22(a). Judicial interpretations of aiding and abetting teach that the aider and abettor is, by definition, distinct from the primary violator. Fustok v. ContiCommodity Servs., Inc., 618 F. Supp. 1069, 1072 (S.D.N.Y. 1985) (person may be held liable under CEA for aiding and abetting when he assists another to commit a prohibited act); United States v. Pino-Perez, 870 F.2d 1230, 1231 (7th Cir.), cert. denied, 493 U.S. 901 (1989) (when crime is so defined that participation by another is necessary, other participant is not aider and abettor).

To be liable for aiding and abetting, a wrongdoer need not satisfy independently all of the elements that would be necessary to establish primary liability. See United States v. Stanley, 765 F. 2d 1224, 1242 (5th Cir. 1985), rehearing denied U.S. v. Spiczak, 772 F.2d 904; Picard Chemical Inc. Profit Sharing Plan v. Perrigo Co., 940 F. Supp. 1101, 1119 (W.D.Mich. 1996) (distinguishing primary violations from aiding and abetting liability). For criminal aiding and abetting liability to attach, it is not even necessary that an aider and abettor know all the details of the crime. United States v. Grubczak, 793 F.2d 458, 463 (2d Cir. 1986). As this case law shows, the aider and abettor's liability arises not by virtue of being an additional principal, but by knowingly providing substantial assistance to the unlawful activity.

The conclusion that § 22(a)(1) does not require that an aider and abettor independently satisfy subparagraphs (A) through (D) also draws support from § 13(a) of the CEA.[4]

See Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 570 (1995) (identical words used in different parts of the same act generally are intended to have the same meaning). Section 13(a) was amended as part of the Futures Trading Act of 1982, the same legislation that created § 22. In that year, Congress amended § 13(a) to remove language restricting its application to administrative proceedings brought under the CEA. The legislative history reflects that Congress intended with this change to extend § 13(a) to "both court proceedings and administrative proceedings under the Act." H.R. Rep. No. 565, Part 1, 97th Cong., 2nd Sess. at 104-105. Since both § 13(a) and § 22(a)(1) refer to one who "willfully aids, abets, counsels . . . induces, or procures the commission of

---

[4] Section 13(a) of the CEA states that:

> Any person who commits, or who willfully aids, abets, counsels, commands, induces, or procures the commission of a violation of any of the provisions of this Act, or of any of the rules, regulations or orders issued pursuant to this Act, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done which if directly performed or omitted by him or another would be a violation of the provisions of this Act or any of such rules, regulations, or orders may be held responsible for such violation as a principal.

a violation," it is reasonable to assume that this language in § 22(a)(1), like the corresponding language in § 13(a), was not intended to be limited in its application to those who satisfy subparagraphs (A) through (D) of § 22(a)(1).

Indeed, had Congress intended in drafting § 22(a) to graft on to aider and abettor liability substantial and unprecedented limitations on its scope, one would expect to find some evidence of such an intent in the legislative history of the 1982 Act. No such evidence exists. To the contrary, Congress broadened the application of aider and abettor liability in § 13(a) to permit its use in "court proceedings." H.R. Rep. No. 565 at 105.

The Commission's interpretation of the scope and application of the aiding and abetting language in § 22(a) is not inconsistent with Congress' intent that § 22(a) confer a limited private right of action for damages. Under the view that we urge herein, the alder and abettor still must aid and abet a primary violator who stands in one of the defined required transactional relationships with the plaintiff.

Nor would the interpretation that we urge here expand aiding and abetting liability under § 22(a) beyond conventional and recognized bounds. One who seeks to prove aiding and abetting faces a considerable hurdle. Aiding and abetting liability requires that the alleged aider and abettor know that he is assisting a wrongful act. In re Temporomandibular Joint (TMJ) Implants, 113 F.3d 1484, 1495 (8th Cir. 1997). He also must take an active role in the misconduct because he must give, at a minimum, substantial assistance to the primary violator's wrongdoing. Walck v. American Stock Exchange, Inc., 687 F.2d 778, 791 (3d Cir.

1982). Where all the prerequisites to aiding and abetting liability are alleged, it would be contrary to the remedial purposes of the CEA to construe subsections (A) through (D) to preclude liability on the part of one who aids and abets another person who satisfies those criteria.

The private right of action granted by § 22 advances important policy objectives. It provides a means of compensating persons injured through commodities trading while at the same time enforcing compliance with the CEA. Given the limited resources of the government, private rights of action are an important supplement to government enforcement actions in helping to ensure lawful conduct in the commodities industry. See Curran, 456 U.S. 384-85 (private litigation is a valuable component of industry self-regulation). The express recognition of the need for aider and abettor liability in private actions under the CEA reflected in § 22 should not be undercut by an unduly restrictive reading of that Section.

CONCLUSION

For the foregoing reasons, the CFTC respectfully submits that a valid cause of action may be stated under § 22 of the CEA against one who aids and abets a violation of § 22, when the primary violator satisfies the requirements of § 22(a)(l)(A) through (D).

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Dated: March 30, 1998

APPENDIX E

SUPERIOR COURT OF NEW JERSEY

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583 NEWARK AVENUE
JERSEY CITY, N.J. 07306
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CHAMBERS OF
SEYMOUR MARGULIES
JUDGE

NOT FOR PUBLICATION WITHOUT THE APPROVAL OF THE COMMITTEE ON OPINIONS

LETTER OPINION

October 31, 1996

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William T. Marshall, Jr., Esq.
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Re: **Equidex, Inc. v. National Futures Association**
Docket No. HUD-L-9424-92

Dear Counselors:

Mr. Cole wanted a one year subscription to the Commodex System so he could collect information via the TYMNET data network using his PC and modem. It's an on-line service for investors interested in the commodities line. He addressed his order to "Commodex, Equidex Inc., 7000 Boulevard East, Guttenberg, NJ." Being dissatisfied with the service, he wanted Equidex to refund his money and asserted a claim against Equidex.

Equidex denied that Cole was its client and denied liability for the Commodex System, asserting that its operation is separate from Equidex, though under the common control of Philip Gotthelf.

Equidex is a member of NFA (National Futures Association) as a Commodity Trading Advisor.

Cole demanded arbitration with NFA against Equidex under the NFA Code of Arbitration. An award was entered back in 1990 against Equidex. Equidex challenged the jurisdiction of the arbitrators and has not yet paid the award.

In 1991 a settlement agreement was executed by Equidex and NFA.

Among other clauses, it provided:

> WHEREAS, the parties hereto desire to settle any and all claims against each other, the parties having negotiated an amicable resolution.
>
> . . .
>
> NFA agrees not to initiate any disciplinary action against Equidex for the activities of Commodex unless there is evidence establishing that either an agency or apparent agency relationship exists between the two entities (excepting use of existing stationery and listing of parties on same stationery for the period of eighteen (18) months as set forth in paragraph 1 herein).
>
> If Equidex decides to file an action against Cole to vacate the arbitration award pursuant to Section 10 of the Federal Arbitration Act, NFA will not file an amicus curiae brief on behalf of Cole.

Because Equidex has not paid the arbitration award, NFA suspended it pursuant to the second sentence of Section 10(g) of the NFA's Code of Arbitration which provides in its entirety:

> The failure of a Member or employee thereof, or Associate, to comply with an award shall be grounds for disciplinary action under NFA Compliance Rules (see Compliance Rule 2-5). When any Member or employee thereof,

> or Associate, fails to comply with an award within 30 days from the date of service of the award by NFA or such other period as specified in the award, and unless there is pending a request to modify the award under Section 10(c) or an application to vacate, modify or correct the award in a court of competent jurisdiction, that Member or Associate may, on seven days written notice, be summarily suspended by the President until such award has been satisfied.

Equidex brought the present action against NFA alleging that the suspension violated the settlement agreement; that NFA had agreed not to initiate a disciplinary action against Equidex for the activities of Commodex unless the agency relationship was established; that a suspension is a disciplinary action; and that the dispute involving Commodex was resolved and any claims were settled.

The agreement was reached after the parties had been in Federal litigation.

The settlement agreement does not expressly refer to the arbitration award although it was a material factor in the dispute. There was voluminous documentation submitted on the cross motions of the parties for summary judgment. Facts are not in dispute. The principal issue concerns the extent, if any, to which the settlement agreement prevents NFA from suspending Equidex. Equidex never administratively appealed the award; nor did it judicially challenge the award although the code provides for these procedures. The suspension was not for any wrongful conduct of, or

concerning, or relating to Commodex but for failing to pay the arbitration award. The payment of the award would have prevented or terminated the suspension. Any fear that payment would be an admission of fault could have ben alleviated by a conditional payment - or one under reservation of rights.

As a member of NFA, Equidex is bound by its rules - its rules are in the nature of agreements with all its members. It has compliance rules, enforcement of which affect the integrity of the organization and its members.

The settlement agreement does not bar the suspension of Equidex.

If the parties did not intend to allow NFA to enforce this past award, they should have said so. The language used limiting the fight of NFL "to initiate" any "disciplinary" action unless evidence of agency existed is as to future Commodex activities.

It is not reasonable or legally sound to assume that Equidex intended not to obey the order of the arbitrators. Each of the numbered paragraphs of the settlement agreement refer to in futuro conduct - not past conduct. The word "initiate" which is in paragraph 6 is also in paragraph 4; both speak in futuro. If Equidex had intended to simply disregard the award, there would be no reason for paragraph 8. Paragraph 8 allows for an application to vacate the award. Equidex was to pay it or seek to vacate it. It did neither. Paragraph 8 expressly refers to Section 10 of the Code of Arbitration. This is the very section that allows for

suspension if there is no application to vacate. The, parties were, in fact, aware of the provisions of Section 10.

Plaintiff has pleaded a variety of claims founded in the theory that the suspension was unlawful but has not asserted a claim to vacate the award.

The suspension is lawful and precludes the plaintiff from any claims for relief. Defendant's motion is granted; plaintiff's is denied. Submit order.

Very truly yours,

/s/_____
Seymour Margulies, J.S.C.

SM:bc

APPENDIX F

CHAPTER 2

PURPOSES

NFA [¶ 4023] Bylaw 201. Purposes

NFA's purposes are as stated in Article III of NFA's Articles of Incorporation (hereinafter "Articles").

ARTICLES OF INCORPORATION
OF
NATIONAL FUTURES ASSOCIATION

ARTICLE III: PURPOSES

[¶ 3023.1] Section 1: Fundamental Purposes.

Subject to the limitations in Section 2 of this Article, the fundamental purposes of NFA are to promote the improvement of business conditions and the common business interests of persons engaged in commodity futures activity by (i) undertaking the regulation of persons that are members of NFA (hereinafter "Members") as set forth in this Article; (ii) relieving the Commodity Futures Trading Commission (hereinafter "Commission") from the substantial burden of direct regulation in such matters; and (iii) facilitating the allocation of increased Commission resources to contract market designations, approval of contract market rules, registration of industry professionals and other duties of the Commission affecting the growth of the commodity futures

industry and the public's ability to avail itself of the industry's expanding services. Actions of NFA to effectuate these purposes may include:

(a) Public Interest.

The adoption, administration and enforcement as to the following persons of requirements regarding fair practice and designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect the public interest:

-- Members that are registered with the Commission as Futures Commission Merchants, Commodity Pool Operators, Commodity Trading Advisors, Introducing Brokers or Leverage Transaction Merchants; and

--Associates (see Article XVIII).

APPENDIX G

CHAPTER 11

DOING BUSINESS WITH NON-MEMBERS

NFA [¶ 2391 Bylaw 1101. Prohibition.

No Member may carry an account, accept an order or handle a transaction, in commodity futures contracts, for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission as an FCM, Introducing Broker, Commodity Pool Operator, Commodity Trading Advisor, or Leverage Transaction Merchant, and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or any other person, unless (a) such non-member of NFA is a member of another futures association registered with the Commission under Section 17 of the Act, or is exempted from this prohibition by Board resolution, or (b) such suspended Member is exempted from this prohibition by the Appeals Committee. No Member may accept orders in commodity futures contracts to cover leverage transactions, for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission as a Leverage Transaction Merchant, unless (a) such non-Member is a member of another futures association registered under Section 17 of the Act, or is exempted from this prohibition by Board resolution, or (b) such suspended Member is exempted from this prohibition by the Appeals Committee.

[See Interpretive Notice at ¶ 9007.]

CFTC Reg. § 166.3 Supervision.

Each Commission registrant, except an associated person who has no supervisory duties, must diligently supervise the handling by its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function), relating to its business as a Commission registrant.

APPENDIX H

[¶9007] Compliance With Bylaw 1101
(Staff, March 19, 1987)

INTERPRETIVE NOTICE

Mandatory membership in NFA is the cornerstone of NFA's regulatory structure. From the earliest stages of its formation, NFA's founders recognized that the creaction of a meaningful and effective industry-wide self-regulatory organization would be completely impossible unless all persons required to be registered as FCMs, IBs, CPOs or CTAs were required to be Members. The founders of NFA considered the issue to be of such critical importance that they not only prohibited the conduct of customer business with non-Members through NFA Bylaw 1101, but included that prohibition as one of NFA's fundamental purposes in Article III, Section l(f) of NFA's Articles of Incorporation. (Exhibit N).

Given the importance of the mandatory membership concept, NFA Bylaw 1101, which tracks the language of Article III, Section l(f), states the prohibition in the strongest possible terms. [See ¶4239 for the text of Bylaw 1101.]

The rule by its terms imposes strict liability on any Member conducting customer business with a non-Member that is required to be registered. The rule does not require proof that the Member firm was at fault or failed to exercise due diligence--simply that it transacted customer business with a non-Member that is required to be registered. NFA Bylaw

1101 requires Members to make two determinations: whether it is doing business with an entity which is required to be registered, and, if so, whether that person is a Member of NFA. The second of these determinations is relatively simple. Any member can call NFA's Information Center at a toll-free number (800-621-3570) to receive current and accurate information concerning the membership status of any person. The determination of whether a particular person is required to be registered can obviously be much more difficult. Any Member could, despite its best efforts, be transacting customer business with a person who is actually required to be registered as an FCM, IB, CPO or CTA. In such a case, the Member is in technical violation of the strict liability terms of NFA Bylaw 1101.

A review of NFA policy, procedures and past disciplinary actions, however, clearly indicates that NFA Bylaw 1101 has not been enforced unreasonably. In making its recommendations in cases involving apparent Bylaw 1101 violations, staff has consistently not relied on the strict liability standard set by the rule itself. Staff has recommended the issuance of complaints in Bylaw 1101 cases in which the evidence indicates that the Member knew or should have known of the violation. Of course, under NFA Compliance Rules, the ultimate decision of whether a particular violation of NFA rules warrants prosection rests with the Members of NFA's Business Conduct Committee ("BCC"). BCC Members exercise their informed business judgment in making these decisions, and are certainly aware that some violations of Bylaw 1101 may occur in spite of reasonably diligent efforts to comply with the rule.

The question of whether a Member should have known of a violation of NFA Bylaw 101 depends in large part on the adequacy of its procedures to prevent such violations. Through it would be impossible to describe all of the situations which should put a Member on notice that a particular person is required to be a Member of NFA, there are certain minimal steps which should be taken to reduce the possibility of a violation of NFA Bylaw 1101:

1. FCM Members should ensure that all omnibus accounts they carry are held by FCM Members of NFA;

2. Each Member should review the list of CFTC registrants with which it does business to determine if they are NFA Members;

3. Each Member should review its list of customers. If a customer's name indicates that it may be engaged in the futures business, the Member should inquire as to its registration and membership status;

4. NFA Compliance Rule 2-8(e) requires that FCM or IB Members who handle accounts managed by third party account controllers, must obtain either an acknowledgment that the customer had received a disclosure document or a written statement from the account controller explaining why the disclosure document need not be provided. When the account controller has provided a disclosure document, the Member should check the

account controller's membership status. When the account controller claims an exemption from disclosure requirements, his written explanation should be reviewed to determine whether the claim on its face is valid;

5. If any customer is operating a commodity pool but claims to be exempt from registration as a CPO, the Member should verify that the customer has made the required filings with the CFTC and NFA;

6. Members should ensure that their branch offices are not seperately incorporated entities. The CFTC Division of Trading and Markets has issued an interpretive letter stating that branch offices, which are separately incorporated entities, are required to be registered as introducing brokers; and

7. FCM Members should determine whether non-Member foreign brokers for whom the Member carries accounts solicit U.S. customers for transactions on U.S. exchanges.

As mentioned above, these suggested steps do not purport to be a dispositive list of internal procedures required to prevent violation of NFA Bylaw 1101. Though under some circumstances a Member following these suggestions could still be found liable for a violation of NFA Bylaw 1101, the suggested procedures should help foster compliance with NFA Bylaw 1101 and greater protection to the investing public.

APPENDIX I

A Compliance Guide:

Futures Commission Merchants and Introducing Brokers

National Futures Association

NFA: A Brief History

National Futures Association (NFA) became operational on October 1, 1982, as the first industrywide self-regulatory organization for the rapidly growing futures industry. The events which led to its creation, however, had their beginning some eight years earlier with the enactment of the Commodity Futures Trading Commission Act (Act) of 1974.

That Act which amended the existing law governing futures trading simultaneously established the Commodity Futures Trading Commission (CFTC) as an independent agency with exclusive jurisdiction over futures trading and authorized the creation, by the futures industry, of "registered futures associations." In addition, the Act provided for the regulation of sectors of the futures industry not previously subject to regulation.

It was clearly the hope of Congress that, given the opportunity and necessary authority, a self-regulatory organization could play a major role in assuring compliance with the Act's requirements and in achieving its objectives.

Notwithstanding extensive groundwork by members of the futures industry, it was not until 1978, when Congress specifically authorized mandatory membership, that the last major obstacle to the establishment of an effective self-regulatory organization was removed. In March of 1981, application was made to the CFTC for designation as a registered futures association. That registration was granted in September of 1981 and a year later NFA officially began operations.

Responsibilities of NFA

NFA's primary responsibility is to assure, through self-regulation, high standards of professional conduct and financial responsibility on the part of the individuals and organizations that are its Members. In addition to Futures Commission Merchants (FCMs) and Introducing Brokers (IBs), these include Commodity Pool Operators (CPOs), Commodity Trading Advisors (CTAs) and Associated Persons (APs) of any of the foregoing.

The key to NFA's regulatory effectiveness is the requirement, Bylaw 1101, which stipulates, that no NFA Member may accept a futures or an option on futures order from another person acting on behalf of a customer unless that other person is a member of a registered futures association. NFA is currently the only such association.

Simply stated, this means that persons who are not or do not remain qualified for NFA membership are prevented or barred from dealing with the public in a business that involves buying or selling futures or options contracts for commodity customers. This is because they will be unable to

obtain execution of their orders. This restriction is commensurate with the resolve of the futures industry that those who do not conduct their business by prescribed rules and standards shall not, in this industry, conduct business at all.

In connection with its self-regulatory responsibilities, NFA conducts periodic audits of its Members' financial and other records, monitors sales practices, and provides a mechanism for the arbitration of futures-related disputes between NFA Members and their customers. NFA also provides a mechanism for the arbitration of Member-to-Member disputes and carries out a variety of educational activities for the benefit of its Members and the investing public.

In addition, NFA is responsible for the processing of applications by futures firms and professionals for registration with the CFTC.

Further, more detailed information about NFA and its various activities is contained in the following publications, available by contacting the Information center at (312) 781-1410:

APPENDIX J

7 U.S.C. § 21.
Registered futures associations

(a) Registration statement

Any association of persons may be registered with the Commission as a registered futures association pursuant to subsection (b) of this section, under the terms and conditions hereinafter provided in this section, by filing with the Commission for review and approval a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

> (1) Data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest; and
>
> (2) Copies of its constitution, charter, or article of incorporation or association, with all amendments thereto, and of its bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this section collectively referred to as the "rules of the association".

(b) Standards for registration; Commission findings

An applicant association shall not be registered as a futures association unless the Commission finds, under standards established by the Commission, that–

(1) such association is in the public interest and that it will be able to comply with the provisions of this section and the rules and regulations thereunder and to carry out the purposes of this section;

(2) the rules of the association provide that any person registered under this chapter, contract market, or any other person designated pursuant to the rules of the Commission as eligible for membership may become a member of such association, except such as are excluded pursuant to paragraph (3) or (4) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest and to carry out the purpose of this section. Rules adopted by the association may provide that the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public interest so to direct, deny admission to, or refuse to continue in such association any person if (i) such person, whether prior or subsequent to becoming registered as such, or (ii) any person associated within the meaning of "associated person" as set forth in

section 6k of this title, whether prior or subsequent to becoming so associated, has been and is suspended or expelled from a contract market or has been and is barred or suspended from being associated with all members of such contract market, for violation of any rule of such contract market;

(3) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall be admitted to or continued in membership in such association, if such person–

> (A) has been and is suspended or expelled from a registered futures association or from a contract market or has been and is batted or suspended from being associated with all members of such association or from being associated with all members of such contract market, for violation of any rule of such association or contract market which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade;
>
> (B) is subject to an order of the Commission denying, suspending, or revoking his registration pursuant to section 9 of this title, or expelling or suspending him from membership in a registered futures association

or a contract market, or barring or suspending him from being associated with a futures commission merchant;

(C) whether prior or subsequent to becoming a member, by his conduct while associated with a member, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such member, and in entering such a suspension, expulsion, or order, the Commission or any such contract market or association shall have jurisdiction to determine whether or not any person was a cause thereof; or

(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who would be ineligible for admission to or continuance in membership under clause (A), (B), or (C) of this paragraph;

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated with a member in conformity with specified and appropriate standards with respect to the training, experience, and such

other qualifications of such person as the association finds necessary or desirable, and in the case of a member, the financial responsibility of such a member. For the purpose of defining such standards and the application thereof, such rules may–

(A) appropriately classify prospective members (taking into account relevant matters, including type or nature of business done) and persons proposed to be associated with members;

(B) specify that all or any portion of such standard shall be applicable to any such class;

(C) require persons in any such class to pass examinations prescribed in accordance with such rules;

(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members) of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate;

(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the training, experience, and

other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association shall adopt procedures for verification of qualifications of the applicant, which may require the applicant to be fingerprinted and to submit, or cause to be submitted, such fingerprints to the Attorney General for identification and appropriate processing. Notwithstanding any other provision of law, such an association may receive from the Attorney General all the results of such identification and processing; and

(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by such rules (and any application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of section 9 of this title, be deemed an application required to be filed under this section);

(5) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs;

(6) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration;

(7) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, in general, to protect the public interest, and to remove impediments to and perfect the mechanism of free and open futures trading;

(8) the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules;

(9) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and persons associated with members and the denial of membership to any person seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include–

> (A) a statement setting forth any act or practice in which such member or other person may be

found to have engaged, or which such member or other person may be found to have omitted;

(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation;

(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade; and

(D) a statement setting forth the penalty imposed;

In any proceeding to determine whether a person shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the person shall be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial or bar is based;

(10) the rules of the association provide a fair, equitable, and expeditious procedure through arbitration or otherwise for the settlement of customers' claims and grievances against any member or employee thereof: Provided, That (A) the use of such procedure by a customer shall be voluntary, (B)

the term "customer" as used in this paragraph shall not include another member of the association, and (C) in the case of a claim arising from a violation in the execution of an order on the floor of a contract market, such procedure shall provide, to the extent appropriate–

(i) for payment of actual damages proximately caused by such violation. If an award of actual damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under section 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award; and

(ii) where the violation is willful and intentional, for payment to the customer of punitive or exemplary damages, in addition to losses proximately caused by the violation, in an amount equal to no more than two times the amount of such losses. If punitive or exemplary damages are awarded against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of such order is held to be responsible under section 4 of this title for the floor broker's violation, such futures commission merchant may be required to

satisfy the award of punitive or exemplary damages ff the floor broker fails to do so, except that such requirement shall apply to the futures commission merchant only if it willfully and intentionally selected the floor broker with the intent to assist or facilitate the floor broker's violation; and

(11) such association provides for meaningful representation on the governing board of such association of a diversity of membership interests and provides that no less than 20 percent of the regular voting members of such board be comprised of qualified nonmembers of or persons who are not regulated by such association.

(12) (A) such association provides on all major disciplinary committees for a diversity of membership sufficient to ensure fairness and to prevent special treatment or preference for any person in the conduct of disciplinary proceedings and the assessment of penalties.

(13) A major disciplinary committee hearing a disciplinary matter shall include–

(A) qualified persons representing segments of the association membership other than that of the subject of the proceeding; and

(B) where appropriate to carry out the purposes of this paragraph, qualified persons who are not members of the association.

(c) Suspension of registration

The Commission may, after notice and opportunity for hearing, suspend the registration of any futures association if it finds that the rules thereof do not conform to the requirements of the Commission, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.

(d) Fees and charges

In addition to the fees and charges authorized by section 12a(1) of this title, each person registered under this chapter, who is not a member of a futures association registered pursuant to this section, shall pay to the Commission such reasonable fees and charges as may be necessary to defray the costs of additional regulatory duties required to be performed by the Commission because such person is not a member of a registered futures association. The Commission shall establish such additional fees and charges by rules and regulations.

(e) Registered persons not members of registered associations

Any person registered under this chapter, who is not a member of a futures association registered pursuant to this section, in addition to the other requirements and obligations of this chapter and the regulations thereunder shall be subject to such other rules and regulations as the Commission may find necessary to protect the public interest and promote just and equitable principles of trade.

(f) Denial of registration

Upon filing of an application for registration pursuant to subsection (a) of this section, the Commission may by order grant such registration if the requirements of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration.

(g) Withdrawal from registration; notice of withdrawal

A registered futures association may, upon such reasonable notice as the Commission may deem necessary in the public interest, withdraw from registration by filing with the Commission a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe.

(h) Commission review of disciplinary actions taken by registered futures associations

(1) If any registered futures association takes any final disciplinary action against a member of the association or a person associated with a member, denies admission to any person seeking membership therein, or bars any person from being associated with a member, the association promptly shall give notice thereof to such member or person and file notice thereof with the Commission. The notice shall be in such form and contain such information as the Commission, by rule or regulation, may prescribe as necessary or appropriate to carry out the purposes of this chapter.

(2) Any action with respect to which a registered futures association is required by paragraph (1) to file notice shall be subject to review by the Commission on its motion, or on application by any person aggrieved by the action. Such application shall be filed within 30 days after the date such notice is filed with the Commission and received by the aggrieved person, or within such longer period as the Commission may determine.

(3)(A) Application to the Commission for review, or the institution of review by the Commission on its own motion, shall not operate as a stay of such action unless the Commission otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of the submission of affidavits or presentation of oral arguments).

(B) The Commission shall establish procedures for expedited consideration and determination of the question of a stay.

(i) Notice; hearing; findings; cancellation, reduction, or remission of penalties; review by court of appeals

(1) In a proceeding to review a final disciplinary action taken by a registered futures association against a member thereof or a person associated with a member, after appropriate notice and opportunity for a hearing (which hearing may consist solely of consideration of the record before the association and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the sanction imposed by the association)--

(A) if the Commission finds that–

(i) the member or person associated with a member has engaged in the acts or practices, or has omitted the acts, that the association has found the member or person to have engaged in or omitted;

(ii) the acts or practices, or omissions to act, are in violation of the rules of the association specified in the determination of the association; and

(iii) such rules are, and were applied in a manner, consistent with the purposes of this chapter, the Commission, by order, shall so declare and, as appropriate, after the sanction imposed by the association, modify the sanction in accordance with paragraph (2), or remand the case to the association for further proceedings; or

(B) if the Commission does not make any such finding, the Commission, by order, shall set aside the sanction imposed by the association and, if appropriate, remand the case to the association for further proceedings.

(2) If, after a proceeding under paragraph (1), the Commission finds that any penalty imposed on a member or person associated with a member is excessive or oppressive, having due regard for the public interest, the Commission, by

order, shall cancel, reduce, or require the remission of the penalty.

(3) In a proceeding to review the denial of membership in a registered futures association or the barring of any person from being associated with a member, after appropriate notice and opportunity for a hearing (which hearing may consist solely of consideration of the record before the association and opportunity for the presentation of supporting reasons to affirm, modify, or set aside the action of the association)--

(A) if the Commission finds that–

(i) the specific grounds on which the denial or bar is based exist in fact;

(ii) the denial or bar is in accordance with the rules of the association; and

(iii) such rules are, and were applied in a manner, consistent with the purposes of this chapter, the Commission, by order, shall so declare and, as appropriate, affirm or modify the action of the association, or remand the case to the association for further proceedings; or

(B) if the Commission does not make any such finding, the Commission, by order, shall set aside the action of the association and require the association to admit the applicant to membership or permit the person to be associated with a member, or, as

appropriate, remand the case to the association for further proceedings.

(4) Any person aggrieved by a final order of the Commission entered under this subsection may file a petition for review with a United States court of appeals in the same manner as provided in section 9 of this title.

(j) Changes or additions to association rules

Every registered futures association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a) of this section. A registered futures association shall submit to the Commission any change in or addition to its rules and may make such rules effective ten days after receipt of such submission by the Commission unless, within the ten-day period, the registered futures association requests review and approval thereof by the Commission or the Commission notifies such registered futures association in writing of its determination to review such rules for approval. The Commission shall approve such rules if such rules are determined by the Commission to be consistent with the requirements of this section and not otherwise in violation of this chapter or the regulations issued pursuant to this chapter, and the Commission shall disapprove, after appropriate notice and opportunity for hearing, any such rule which the Commission determines at any time to be inconsistent with the requirements of this

section or in violation of this chapter or the regulations issued pursuant to this chapter. If the Commission does not approve or institute disapproval proceedings with respect to any rule within one hundred and eighty days after receipt or within such longer period of time as the registered futures association may agree to, or if the Commission does not conclude a disapproval proceeding with respect to any rule within one year after receipt or within such longer period as the registered futures association may agree to, such rule may be made effective by the registered futures association until such time as the Commission disapproves such rule in accordance with this subsection.

(k) Abrogation of association rules; requests to associations by Commission to alter or supplement rules

(1) The Commission is authorized by order to abrogate any rule of a registered futures association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or effectuate the purposes of this section.

(2) The Commission may in writing request any registered futures association to adopt any specified alteration or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested,

or with such modifications of such alteration or supplement as it deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or to effectuate the purposes of this section, with respect to--

(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with members, or the qualifications required for members or natural persons associated with members or any class thereof;

(B) the method for adoption of any change in or addition to the rules of the association;

(C) the method of choosing officers and directors.

(l) Suspension and revocation of registration; expulsion of members; removal of association officers or directors

The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or to carry out the purposes of this section–

(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered futures association, if the Commission

finds that such association has violated any provisions of this chapter or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this chapter;

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered futures association any member thereof, or to suspend for a period not exceeding twelve months or to bar any person from being associated with a member thereof, if the Commission finds that such member or person–

> (A) has violated any provision of this chapter or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this chapter or any rule or regulation thereunder; or
>
> (B) has willfully violated any provision of this chapter, or of any rule, regulation, or other thereunder, or has effected any transaction for any other person who, he had reason to believe, was wilfully violating with respect to such transaction any provision of this chapter or rule, regulation, or order; and

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or

director of a registered futures association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.

(m) Rules requiring membership in associations

Notwithstanding any other provision of law, the Commission may approve rules of futures associations that, directly or indirectly, require persons eligible for membership in such associations to become members of at least one such association, upon a determination by the Commission that such rules are necessary or appropriate to achieve the purposes and objectives of this chapter.

(n) Reports to Congress

The Commission shall include in its annual reports to Congress information concerning any futures associations registered pursuant to this section and the effectiveness of such associations in regulating the practices of the members.

(o) Delegation to futures associations of registrative functions; discretionary review by Commission; judicial appeal

(1) The Commission may require any futures association registered pursuant to this section to perform any portion of the registration functions under this chapter with respect to each member of the association other than a contract market and with respect to each associated person of such member, in accordance with rules, notwithstanding any other provision of law, adopted by such futures association

and submitted to the Commission pursuant to subsection (j) of this section and subject to the provisions of this chapter applicable to registrations granted by the Commission.

(2) In performing any Commission registration function authorized by the Commission under section 12a(10) of this title, this section, or any other applicable provisions of this chapter, a futures association may issue orders (A) to refuse to register any person, (B) to register conditionally any person, (C) to suspend the registration of any person, (D) to place restrictions on the registration of any person, or (E) to revoke the registration of any person. If such an order is the final decision of the futures association, any person against whom the order has been issued may petition the Commission to review the decision. The Commission may on its own initiative or upon petition decline review or grant review and affirm, set aside, or modify such an order of the futures association; and the findings of the futures association as to the facts, if supported by the weight of the evidence, shall be conclusive. Unless the Commission grants review under this section of an order concerning registration issued by a futures association, the order of the futures association shall be considered to be an order issued by the Commission.

(3) Nothing in this section shall affect the Commission's authority to review the granting of a registration application by a registered futures association that is performing any Commission registration function authorized by the Commission under section 12a(10) of this title, this section, or any other applicable provision of this chapter.

(4) If a person against whom a futures association has issued a registration order under this subsection petitions the Commission to review that order and the Commission declines to take review, such person may file a petition for review with a United States court of appeals, in accordance with section 9 of this title.

(p) Establishment of rules for futures associations; approval by Commission

Notwithstanding any other provision of this section each futures association registered under this section on January 11, 1983, shall adopt and submit for Commission approval not later than ninety days after such date, and each futures association that applies for registration after such date shall adopt and include with its application for registration, rules of the association that require the association to--

(1) establish, training standards and proficiency testing for persons involved in the solicitation of transactions subject to the provisions of this chapter, supervisors of such persons, and all persons for which it has registration responsibilities, and a program to audit and enforce compliance with such standards;

(2) establish minimum capital, segregation, and other financial requirements applicable to its members for which such requirements are imposed by the Commission and implement a program to audit and enforce compliance with such requirements, except that such requirements may be less stringent than those imposed on such firms by this chapter or by Commission regulation;

(3) establish minimum standards governing the sales practices of its members and persons associated therewith for transactions subject to the provisions of this chapter; and

(4) establish special supervisory guidelines to protect the public interest relating to the solicitation by telephone of new futures or options accounts and make such guidelines applicable to those members determined to require such guidelines in accordance with standards established by the Commission consistent with this chapter. Such guidelines may include a requirement that, with respect to a customer with no previous futures or commodity options trading experience, the member may not enter an order for the account of such customer for a period of three days following opening of the account and receipt of a signed acknowledgment by the customer of receipt of a risk disclosure statement.

(q) Major disciplinary rule violations

(1) The Commission shall issue regulations requiring each registered futures association to establish and make available to the public a schedule of major violations of any rule within the disciplinary jurisdiction of such registered futures association.

(2) The regulations issued by the Commission pursuant to this subsection shall prohibit, for a period of time to be determined by the Commission, any member of a registered futures association who is found to have committed any major violation from service on the governing board of any

registered futures association or contract market, or on any disciplinary committee thereof.

(q) Program for implementation of rules

Each futures association registered under this section shall develop a comprehensive program that fully implements the rules approved by the Commission under this section as soon as practicable but not later than September 30, 1985, in the case of any futures association registered on January 11, 1983, and not later than two and one-half years after the date of registration in the case of any other futures association registered under this section.

1978 - Subsec. (b)(3)(B). Pub.L. 95-405, Sec. 22(1), struck out "(7 U.S.C. § 9)" after "section 9 of this title".

Subsec. (b)(10). Pub.L. 95-405, Sec. 22(2), substituted "$15,000" for "$5,000".

Subsec. (l) (1), (2)(A). Pub.L. 95-405, Sec. 22(3), substituted "chapter" for "section" wherever appearing.

Subsecs. (m), (n). Pub.L. 95-405, Sec. 22(4), added subsec. (m) and redesignated former subsec. (m) as (n).

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub.L. 97-444 effective Jan. 11, 1983, see section 239 of Pub.L. 97-444, set out as a note under section 2 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Amendment by Pub.L. 95-405 effective Oct. 1, 1978, see section 28 of Pub.L. 95-405, set out as a note under section 2 of this title.

EFFECTIVE DATE

For effective date of section, see section 418 of Pub.L. 93-463, set out as an Effective Date of 1974 Amendment note under section 2 of this title.

APPENDIX K

7 U.S.C. 25(b) (2), (3), (4) and (5)

(b) Liabilities of organizations and individuals; bad faith requirement; exclusive remedy

(2) A registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title or in enforcing any such bylaw or rule violates this chapter or any Commission rule, regulation, or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule.

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a contract market, clearing organization, licensed board of trade, or a registered futures association willfully aids, abets, counsels, induces, or procures any failure by any such entity to enforce (or any violation of the chapter in enforcing) any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, shall be liable for actual damages sustained by a person who engaged in any transaction specified in subsection (a) of this section on, or subject to the rules of such contract market, licensed board of trade or, in the case of an officer, director, governor, committee member, or employee of a registered futures association, any transaction specified in subsection (a) of this section, in either case to the extent of such person's actual losses that resulted

from such transaction and were caused by such failure or violation.

(4) A person seeking to enforce liability under this section must establish that the contract market, licensed board of trade, clearing organization, registered futures association, officer, director, governor, committee member, or employee acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss.

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this chapter available to any person who sustains a loss as a result of (A) the alleged failure by a contract market, licensed board of trade, clearing organization, or registered futures association or by any officer, director, governor, committee member, or employee to enforce any bylaw, rule, regulation or resolution referred to in paragraph (1) or (2) of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution referred to in this subsection that is alleged to have violated this chapter, or any Commission rule, regulation, or order.

APPENDIX L

FUTURES TRADING ACT OF 1982

P.L. 97-444, see page 96 Stat. 2294

HOUSE REPORT NO. 97-565, Part 1
[Page 1]

Page 3871

The Committee on Agriculture, to whom was referred the bill (H.R. 5447), to extend the Commodity Exchange Act, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

FUTURES TRADING ACT
P.L. 97-444
[pages 56-57]

Page 3905-3906

* * *

. . . ment is made. This new procedure is designed to insure the integrity of the reparations program and of the commission's orders and to make the system more equitable for all participants.

In 1978, the Commission obtained changes in the Act which were designed to enlarge the class of persons subject to

the Commission's reparations procedures to include unregistered persons. Over the course of the past four years, the Commission has encountered several obstacles, not anticipated at the time its legislative changes were recommended, to asserting reparations procedures to include unregistered persons. Over the course of the past four years, the Commission has encountered several obstacles, not anticipated at the time its legislative changes were recommended, to asserting reparations jurisdiction over so-called "outlaw" firms or individuals. Unregistered firms and individuals often file in bankruptcy, are destitute, or have disappeared by the time a claim is asserted, resulting in uncollectible reparations awards. In these circumstances, the reparations process actually operates as a disservice to those who have already been harmed, by apparently promising recovery, which as a practical matter cannot be had. Moreover, these types of claims have served to delay the entire reparations process, thereby deferring the completion of cases where recovery is possible.

Thus, a final statutory change made by the committee at the Commission's request was to eliminate reparations claims against individuals or firms not registered with the Commission.

(c) Arbitration

The Committee's proposed amendments to sections 5a(11) and 17(b)(10) of the Act would enhance the attractiveness of arbitration as an alternative to reparations. In particular, the Committee eliminated the $15,000 limitation upon disputes which must be heard by exchanges and registered futures associations, in the expectation that

customers with more sizable claims would be encouraged to arbitrate their claims instead of petitioning for reparations hearings. As sections 5a(11) and 17(b)(10) currently read, exchanges and registered futures associations may refuse to arbitrate a customer's claim against one of their members or employees if the amount in question exceeds $15,000. The Committee is of the view that arbitration is an equally viable forum for resolving customer claims in excess of $15,000 and there is no logical reason why reparations should be the only out-of-court forum for resolution of these disputes.

The Committee proposed amendment to sections 5a(11) and 17(b)(10) would also delete the present language in the Act requiring that the arbitration procedures not result in any compulsory payment except as agreed upon by the parties. This change is intended to make clear that awards rendered on counter-claims in arbitration are binding without the necessity of any agreement. H.R. 5447 does not affect the existing requirement that the use of arbitration by the customer is voluntary or the Commission's understanding that exchange members must participate in arbitration proceedings which the customer has elected to pursue.

(d) Private Rights of Action

At the time the Committee considered the bill, the Supreme Court had not yet resolved the issue of whether a private right of action could be implied under the Act. The Committee is of the view that the right of an aggrieved person to sue a violator of the Act is critical to protecting the public and fundamental to maintaining the credibility of the futures market.

To that end the Committee added a new section to the bill to provide specific authority for private rights of action for recovery of actual damages against violators of the Act. In order to recover the violation must have arisen from a transaction on the futures market, a regulated option or leverage contract, or participation in a commodity pool.

The Committee also specifically provided for liability for actual damages by a contract market, clearing organization of a contract market, licensed board of trade or registered futures association market, that failed to enforce a bylaw, rule or regulation made a condition of its designation or license. In addition, a cause of action could be brought against an officer, director, or employee who willfully aided or induced such a violation. The cause of action in these cases would be restricted to cases where the plaintiff had engaged in a regulated commodity transaction and could show that there was bad faith in failing to take the necessary action. Any action by a private litigant under the Act must be brought with two years after the date the cause of action accrued.

The Committee included these restriction on the causes of action to avoid suits for speculative damages to assets that are affected by fluctuations in prices on the commodity market but which are not the subject of transactions on such market.

The availability of these remedies-reparations, arbitration and private rights of action-supplements, but does not substitute, for the regulatory and enforcement program of the CFTC and self-regulatory agencies. The Committee fully expects that these agencies will vigorously use the tools at its command to protect the investing public so that it does not

become necessary to rely on private litigants as a policeman of the Commodity Exchange Act.

IX. COMMISSION EMERGENCY POWERS

The Committee included in its amendments to the Commodity Exchange Act new provisions to assure that the Commission would have the tools it needs to act promptly in emergency situations to protect the public interest and at the same time establish a mechanism that will assure that the Commission does not act in an arbitrary or capricious manner.

Under current law in emergency situations the Commission is authorized to "take such action as in the Commission's judgment si necessary to maintain or restore orderly trading in or liquidation of any futures contract." The Act defines the term "emergency" to mean in addition to threatened or actual market manipulation and corners, any action of the United States or a foreign government affecting a commodity or any other major market disturbance which prevents the market from accurately reflecting the forces of supply and demand for such commodity.

As described elsewhere in this report, there was concern as a aftermath of the silver affair as to the breadth of the Commission's powers in emergency situations. Accordingly, the Committee has amended the Act to make explicit that this power of the commission extends to the setting of temporary emergency margin levels

* * *

(2)

Supreme Court, U.S.
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No. 00-733

IN THE

Supreme Court of the United States

RICHARD NICHOLAS, et al.,

Petitioners,

—v.—

SAUL STONE & COMPANY, LLC, et al.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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161 pp

RULE 29.6 STATEMENT

Merrill Lynch & Co., Inc., a publicly held company, is the parent corporation of Respondent Merrill Lynch, Pierce, Fenner & Smith Incorporated. Said respondent is a wholly owned subsidiary of Merrill Lynch & Co., Inc.

Respondent Prudential Securities Incorporated is a subsidiary of Prudential Securities Group and an indirect subsidiary of The Prudential Insurance Company of America. The Prudential Insurance Company of America is respondent's ultimate parent corporation. No publicly held company owns 10% or more of said respondent's stock.

Morgan Stanley Dean Witter & Co., a publicly held company, is the parent corporation of Respondent Dean Witter Reynolds, Inc. Said respondent is a wholly owned subsidiary of Morgan Stanley Dean Witter & Co.

Citigroup, Inc., a publicly held company, is the parent corporation of Respondent Salomon Smith Barney, Inc. Said respondent is a wholly owned subsidiary of Citigroup, Inc.

E.D. & F. Man Group, P.L.C., a publicly held company, is the parent corporation of Respondent E.D. & F. Man International Inc. Said respondent is a wholly owned subsidiary of E.D. & F. Man Group, P.L.C.

TABLE OF CONTENTS

	PAGE
RULE 29.6 STATEMENT	i
TABLE OF AUTHORITIES	iv
PRELIMINARY STATEMENT	1
STATEMENT OF CASE	1
SUMMARY OF ARGUMENT	3
ARGUMENT	4
NO PRIVATE RIGHT OF ACTION EXISTS FOR VIOLATION OF SECTION 1101 OF THE NFA BY-LAWS	4
A. Private Rights of Action May Not Be Implied Without Persuasive Evidence Of Congressional Intent to Create Them	4
B. The CEA's Language Excludes Any Private Right of Action Against the FCMs for Alleged Violation of NFA Bylaw 1101	7
C. The CFA Precludes Implication of Additional Private Rights of Action	8
D. There Is No Conflict Between the Circuits on this Issue	9

PAGE

CONCLUSION 11

APPENDIX

First Amended Complaint Dated November 23, 1997 ..... 1a

TABLE OF AUTHORITIES

Cases: PAGE

Cannon v. University of Chicago, 441 U.S. 677 (1979) 5

Central Bank of Denver, N.A. v. First Interstate Bank of Denver N.A., 511 U.S. 164 (1994).. 5

Cort v. Ash, 422 U.S. 66 (1975) 4

Fustok v. ContiCommodity Services, Inc., 618 F. Supp. 1069 (S.D.N.Y. 1985) 9

Indemnified Capital Investments SA v. R.J. O'Brien & Associates, Inc., 12 F.3d 1406 (7th Cir. 1993)..... 9

In re Lake States Commodities, Inc., 936 F. Supp. 1461 (N.D. Ill. 1996)..... 9, 10

Merrill Lynch, Pierce, Fenner & Smith v. Curran, 456 U.S. 353 (1982)..... 8

Peltz v. SHB Commodities, Inc., 115 F.3d 1082 (2d Cir. 1997) 9

Procter & Gamble Co. v. Bankers Trust & Co., 925 F. Supp. 1270 (S.D.Ohio 1996) 9

Spicer v. Chicago Board of Options Exchange, Inc., 977 F.2d 255 (7th Cir. 1992)..... 4

Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) 4, 5, 6, 7, 8

Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis, 444 U.S. 11 (1979) 4, 5, 6

PAGE

Statutes:

7 U.S.C. § 6(b) 10

7 U.S.C. § 21 7

7 U.S.C. § 25(a)(1) 7, 8, 10

7 U.S.C. § 25(a)(2) 8

7 U.S.C. § 25(b) 8

Futures Trading Act of 1982, Pub. L. 97-444, § 235, 96 Stat. 2294, 2322-24 (Jan. 11, 1983) 9

PRELIMINARY STATEMENT

Respondents Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), Prudential Securities Incorporated ("Prudential"), Smith Barney, Inc. ("Smith Barney"), Dean Witter Reynolds, Inc. ("Dean Witter") and E.D. & F. Man International Inc. ("Man") (collectively "Respondents") respectfully submit this brief in opposition to the Petition for Writ of Certiorari.

Petitioners ask the Supreme Court to create a private right of action under the Commodity Exchange Act ("CEA") for alleged violation of Section 1101 of the Bylaws of the National Futures Association ("NFA"), an issue not properly raised in petitioners' complaint nor fully developed in the opinions of the courts below. The private right of action would run against futures commission merchants ("FCMs") who are NFA members. Since respondents are FCMs, this brief addresses whether Congress provided in the CEA for private rights of action against FCMs for alleged violations of NFA Bylaws.

STATEMENT OF THE CASE

Petitioners now ask the Supreme Court to grant certiorari in order to create an implied private right of action against FCMs for alleged violation of NFA Bylaw 1101. There are two basic reasons to reject petitioners' writ of certiorari: (1) petitioners did not raise this issue below; and (2) the private right of action urged by petitioners has no basis in the precedents of this or other Courts and there is no compelling reason, in policy, statute or otherwise, to create one. Petitioners failed to directly raise the issue they now seek to have this Court review in their 223 paragraph, eleven count Complaint, whether as a separately alleged cause of action or

otherwise. Rather, as described by the district court, the Second Count of petitioners' First Amended Complaint (the "Complaint") asserted that Bylaw 1101 was part of a contract between the NFA and its members of which petitioners were third party beneficiaries and which the FCMs had breached. *See* P.A. 63a.[1] In rejecting that claim, the district court dealt with the issue raised by the Complaint and therefore discussed applicable contract law, noting only in passing that "third party enforcement of the rules of a self-regulatory organization has been considered and rejected by a number of other Courts," citing cases refusing to imply a private right of action under NFA Bylaw 1101 and similar rules. P.A. 67a. In affirming, the Third Circuit did not discuss at all this state law breach of contract claim, relying instead on the district court's opinion on this point. P.A. 29a-30a.

This Court should not depart from its usual course and grant certiorari to rule on an issue not directly raised in the pleadings, nor fully developed in the opinions of the courts below.

Even if the Court determines that petitioners properly raised the issue below, none of the considerations set forth in Supreme Court Rule 10 governing review on certiorari is present in this case. There are no "com-

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[1] The First and Third Counts of the Complaint also mention Bylaw 1101 in connection with the causes of action asserted therein, but these claims either have been abandoned or are not made against the FCMs. The First Count alleged that respondents either violated or aided and abetted violations of the CEA. The district court dismissed the First Count (P.A. 56a-63a); the Third Circuit affirmed (P.A. 18a-29a) and petitioners do not seek this Court's review of the dismissal of the First Count. The Third Count alleged a bad faith failure to enforce NFA rules (including Bylaw 1101), but it was directed solely against the NFA and certain individuals, not against the FCMs. *Id.* A copy of the Complaint is annexed hereto as an Appendix, referred to below as "R.A." The Appendix attached to the Petition is referred to as "P.A."

pelling reasons" warranting review, as evidenced by the fact that petitioners did not even squarely raise the issue below. There is no conflict between the Third Circuit's decision and that of another federal court of appeals or state court of last resort on the same matter, notwithstanding petitioners' assertion of a conflict with an unrelated Second Circuit case. There is no important question of federal law which has not been, but should be, settled by the Supreme Court. To the contrary, the decisions below are wholly consistent with this Court's cases delineating when private rights of action may be implied and cases in other courts specifically rejecting implication of a private right of action under NFA Bylaw 1101 or other similar rules of self-regulatory organizations.

SUMMARY OF ARGUMENT

This Court's precedents are clear: when a party asserts that there is a private right of action under a federal statute the issue is determined by whether Congress, in enacting the statute at issue, intended to create a private remedy. Courts therefore will not imply a private remedy absent persuasive evidence of such Congressional intent.

The CEA expressly sets forth those private rights of action that are available thereunder. These include a carefully described and limited private right of action against a person (including an FCM) who violates or willfully aids and abets the violation of the CEA where such person stands in one of four specified relationships with the plaintiff. The statute does not provide a private remedy for violating Bylaw 1101. Since Congress did provide private rights of action against FCMs, but chose not to include such an action for violating Bylaw 1101, it is clear that Congress did not intend to create this additional private right of action.

Moreover, Congress conclusively expressed its intent not to expand private remedies beyond those it expressly set forth in the CEA by providing not once but twice that the private rights of action it specified therein are the *exclusive* private remedies available to persons damaged by alleged violations of the CEA. Accordingly, the CEA leaves no room to imply additional private rights of action.

ARGUMENT

NO PRIVATE RIGHT OF ACTION EXISTS FOR VIOLATION OF SECTION 1101 OF THE NFA BY-LAWS

A. Private Rights of Action May Not Be Implied Without Persuasive Evidence of Congressional Intent to Create Them.

This Court's central teaching on the issues involved here is that "the question whether a statute creates a cause of action, either expressly or by implication, is basically a matter of statutory construction." *Transamerica Mortgage Advisors, Inc. (TAMA) v. Lewis*, 444 U.S. 11, 15 (1979). As the Court stated in *Touche Ross & Co. v. Redington*, 442 U.S. 560, 575 (1979):

> [I]n *Cort v. Ash*, [422 U.S. 66 (1975),] the Court set forth four factors that it considered 'relevant' in determining whether a private remedy is implicit in a statute not expressly providing one. But the Court did not decide that each of these factors is entitled to equal weight. The central inquiry remains whether Congress intended to create, either expressly or by implication, a private cause of action.

As the Court noted in *Spicer v. Chicago Board of Options Exchange, Inc.*, 977 F.2d 255 (7th Cir. 1992), after

reviewing this Court's precedents, "in sum, courts may not recognize an implied remedy absent persuasive evidence that Congress intended to create one." *Id.* at 265.[2]

Indeed, this Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), together with other Supreme Court decisions, have underscored the strong presumption against implying private causes of action. *Id.* at 179-80. *Cf.*, *TAMA*, 444 U.S. at 22-23 n. 13 ("Congress amended the Investment Company Act in 1970 to create a *narrowly circumscribed right of action* for damages" and these amendments are a "clear indication that Congress knew how to confer a private right of action when it wished to do so") (emphasis added); *Touche Ross*, 442 U.S. at 578 (noting Court's adherence "to a stricter standard for the implication of private causes of action."). As Justice Powell declared in *Cannon v. University of Chicago*, "[a]bsent the *most compelling evidence of affirmative congressional intent*, a federal court should not infer a private cause of action." 441 U.S. 677, 731 (1979) (dissenting opinion) (emphasis added).

Analysis of Congess's intent begins with the language of the statute itself. *Central Bank*, 511 U.S. at 173; *Touche Ross*, *supra*, 442 U.S. at 568. Some important corollar-

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[2] Petitioners' request that the Court "revisit" the *Cort v. Ash* test (P.A. 19-20) is unavailing. As the Court noted in *Touche Ross*, 442 U.S. at 576, the first three *Cort* factors—language and focus of the statute, its legislative history and its purpose—are the traditional factors used in determining legislative intent. Application of these factors confirms that the explicit intent of the CEA was to exclude private remedies not explicitly set forth therein, as discussed below. The fourth *Cort* factor—whether the cause of action is one traditionally relegated to state law—also weighs against petitioners; for as previously noted petitioners' Bylaw 1101 claim appears in the Second Count of the Complaint alleging breach of contract. As both the district court and the Third Circuit pointed out, this is a state law claim. P.A. 63a, 29a.

ies relevant to this case flow from the focus on congressional intent as expressed in the language of the statute. First, where the statute in question explicitly grants private rights of action, an intent to imply additional ones is negated, for "when Congress wished to provide a private damage remedy, it knew how to do so and did so expressly." *Id.* at 572. *See also TAMA*, *supra*, 444 U.S. at 19 ("it is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it"). In the present case, as discussed below, Congress explicitly granted private rights of action in the CEA, including as against FCMs, and emphasized that they were the exclusive private remedies, thus conclusively negating any intent to allow additional ones.

Second, a statute cannot be read more broadly than its language and statutory scheme permits to effectuate some asserted remedial purpose of the statute or because of claims that the statute was intended to benefit the plaintiff's class. *Touche Ross*, *supra*, 442 U.S. at 578; *TAMA*, *supra*, 444 U.S. at 17-18. Here, petitioners' "Argument I" (the only argument in the Petition directed against the FCMs) asks the Court to imply a private right of action against the FCMs because, they allege, failure to do so "frustrates the Congressional goal to protect the investing public" or that Bylaw 1101 is designed "to stop the commencement of fraud." *E.g.*, Petition at 11, 15.[3] However, petitioners' argument is just that—argument, divorced from foundation in the language of the CEA; indeed, petitioners do not cite any provision of the CEA even purporting to provide a private right of action against FCMs for violating NFA Bylaws. *See* Petition at 11-22. Petitioners' claims about the underlying purposes

[3] Petitioners' "Argument II" (Petition at 22-25) purports to be based on statutory language, but that argument is directed solely against respondent NFA and therefore we do not comment on it here.

of the CEA (which are incompletely and inaccurately stated) thus are irrelevant because, borrowing from this Court's language in *Touche Ross*, the CEA "does not by any stretch of its language purport to confer private damages rights" against FCMs for violation of NFA Bylaws. 442 U.S. at 570.

B. The CEA's Language Excludes Any Private Right of Action Against the FCMs for Alleged Violation of NFA Bylaw 1101.

As the Third Circuit noted below, the NFA is a Registered Futures Association which functions as the futures industry's self-regulatory organization under 7 U.S.C. § 21. P.A. 8a n.6. NFA By-law 1101 provides that "no Member may carry an account, accept an order or handle a transaction in commodities futures contracts for or on behalf of any nonMember of the NFA . . . that is required to be registered" with the Commodity Futures Trading Commission ("CFTC"). P.A. 145a.

Petitioners' claim is that the FCMs carried accounts of the perpetrators of a Ponzi scheme who were required to be registered with the CFTC but were not; and the FCMs violated Bylaw 1101 by failing to detect this non-registration. Whatever the merits of this claim, the plain fact is that the CEA does not provide—and indeed excludes —any private right of action against the FCMs on such a claim.

Thus, the CEA expressly sets forth the private rights of action available thereunder. 7 U.S.C. § 25(a)(1) provides for a private right of action for damages caused by "any person . . . who violates this chapter or who willfully aids or abets . . . the commission of a violation of this chapter," where such person stands in one of four specified relationships with the aggrieved person. The Third Circuit held that the Complaint failed to state a

cause of action against the FCMs under 7 U.S.C. § 25(a)(1) because the FCMs did not have (directly or via some agency theory) one of the relationships with petitioners required for primary liability, nor did petitioners' Complaint allege conduct which might render the FCMs liable as aiders or abettors. P.A. 18a-29a. *Petitioners do not seek review of this determination.*

Congress also explicitly provided in the CEA for private rights of action relating to non-enforcement of bylaws. 7 U.S.C. § 25(b). On its face, however, this provision does not apply to the FCMs. Indeed, petitioners do not argue that 7 U.S.C. § 25(b) has any application to the FCMs. Moreover, 7 U.S.C. § 25(a)(1) does not allow for a private right of action based on violations of bylaws.

Accordingly, there is nothing in the express language of the CEA which provides for a private right of action against the FCMs for violation of NFA Bylaw 1101.

C. The CEA Precludes Implication of Additional Private Rights of Action.

Apart from expressly providing for private rights of action against specified parties, the CEA states not once but twice that the private rights of action specified therein are the *exclusive* remedies available under the CEA to individuals. 7 U.S.C. §§ 25(a)(2) and (b)(5). As discussed above, the express provision in the CEA for private rights of action coupled with the express provision that those private rights are exclusive precludes implication of additional private rights under the CEA. *See Touche Ross*, *supra*, 442 U.S. at 572; *TAMA*, *supra*, 444 U.S. at 19.

These exclusive remedies came about as a result of Congress's reaction to this Court's holding in *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353

(1982). The *Curran* Court found that the CEA provided for implied private rights of action. Thereafter, Congress superseded *Curran*—amending the CEA by adding 7 U.S.C. § 25 to provide these exclusive remedies. See Futures Trading Act of 1982, Pub. L. 97-444, § 235, 96 Stat. 2294, 2322-24 (Jan. 11, 1983).

Courts have recognized this settled state of the law by repeatedly holding that no private rights of action exist for violations of the rules of the NFA or other self-regulatory organizations. The Court specifically so held with respect to NFA Bylaw 1101 in *In re Lake States Commodities, Inc.*, 936 F. Supp. 1461, 1468-69 (N.D. Ill. 1996). Additional cases declining to imply private rights of action under the CEA are *Indemnified Capital Investments SA v. R.J. O'Brien & Associates, Inc.*, 12 F.3d 1406, 1412 (7th Cir. 1993); *Procter & Gamble Co. v. Bankers Trust & Co.*, 925 F. Supp. 1270, 1287-88 (S.D.Ohio 1996); *Fustok v. ContiCommodity Services, Inc.*, 618 F. Supp. 1069, 1071-74 (S.D.N.Y. 1985); and the cases cited by the district court below at P.A. 70a.

D. There is No Conflict Between the Circuits on this Issue.

There is no conflict between the circuits on whether a private right of action can be implied against FCMs for alleged violation of NFA Bylaw 1101 or, more generally, for violation of any NFA bylaw or rule.

In an effort to imagine a conflict between the circuits warranting Supreme Court review, petitioners assert that the Third Circuit's decision in this case "ignores" the Second Circuit's decision in *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082 (2d Cir. 1997). See P.A. 13. *Peltz* has nothing to do with this case. It involved a claim that certain trades in plaintiff's account were unauthorized, in violation of the CEA's express prohibition against an

FCM trading for a customer's account without his permission. See 7 U.S.C. § 6(b); 115 F.3d at 1086-87. The issue there was whether, when an FCM executes trades for a customer's account at the direction of a third party, the FCM is under a duty to inquire whether the third party had actual or apparent authority to direct those trades. The Court held that there was no duty of inquiry when the third party had actual authority since such inquiry would be superfluous; but that the FCM must make a reasonable inquiry when asserting a defense of apparent authority. *Id.* at 1089. The decision does not involve or discuss implication of private rights of action, either under NFA Bylaw 1101 or otherwise; an unauthorized trade would violate an express provision of the CEA for which a private right of action for damages is expressly authorized by 7 U.S.C. § 25(a)(1).

Petitioners also seek to distinguish *Lake States Commodities*, *supra*, which squarely held that there was no private right of action under NFA Bylaw 1101, because, as the Court there noted, the plaintiffs had failed to offer "persuasive justification" for departing from the proposition that general rules of exchange organizations do not create private rights of action. See P.A. 14-15. This purported distinction is non-existent: *Lake States* involved facts virtually identical to those in the present case—a Ponzi scheme which an FCM failed to prevent because it breached its alleged duty under Bylaw 1101 to determine that the crooks were not registered. *See* 936 F. Supp. at 1465, 1468-69. *Lake States* thus reasonably cannot be distinguished from this case, either on its facts or the law.

CONCLUSION

The holding below is wholly consistent with this Court's precedents limiting the implication of private rights of action under federal statutes and with the extensive body of cases in the courts of appeals and district courts declining to imply additional rights of action under the CEA in general and NFA Bylaw 1101 in particular. There are no "special and important reasons" compelling review by the Supreme Court. The Petition should be denied.

Respectfully submitted,

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UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action No. 97-860(AET)

RICHARD NICHOLAS; LYNN NICHOLAS; ROBERT M. BLACKBURN; CHERYL S. BLACKBURN; and, On Behalf of Themselves and On Behalf of the Class of All Others Similarly Situated,

Plaintiffs,

—VS.—

SAUL STONE & COMPANY LLC F/K/A SAUL STONE AND COMPANY; FIRST OPTIONS OF CHICAGO, INC. D/B/A LIT DIVISION OF FIRST OPTIONS; SMITH BARNEY, INC.; LFG, LLC F/K/A LINNCO FUTURES GROUP, INC.; GNI INCORPORATED; GNI LIMITED; DEAN WITTER REYNOLDS, INC.; ING (U.S.) SECURITIES FUTURES & OPTIONS, INC. D/B/A ING FUTURES & OPTIONS; MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.; PRUDENTIAL SECURITIES, INC.; ROSENTHAL COLLINS GROUP, L.P. F/K/A ROSENTHAL & COMPANY; E. D. & F.

MAN INTERNATIONAL, INC. F/K/A E. D. & F. MAN INTERNATIONAL SECURITIES, INC.; CLARENCE DELBRIDGE, III; THOMAS H. STONE; NATIONAL FUTURES ASSOCIATION; JOHN DOE; JOAN DOE, JACK DOE; JOSEPH DOE; JANE DOE; JAKE DOE; JEFF DOE; JEAN DOE; JAMES DOE; JILL DOE; and JOEL DOE,

Defendants.

FIRST AMENDED CLASS ACTION COMPLAINT AND DEMAND FOR JURY TRIAL

Plaintiffs named herein bring this action in their individual capacity and on behalf of the class of persons defined below, and all allegations contained in the First Amended Complaint ("Complaint") on the personal knowledge and facts of the named Plaintiffs and otherwise upon information and belief based, *inter alia*, upon the Plaintiffs' direct investigation of known and available facts through themselves and their attorney herein.

JURISDICTION AND VENUE

1. This action arises under the Commodity Exchange Act ("CEA"), as amended, 7 U.S.C. §§ 1 *et seq.*; Title IX of the Organized Crime Control Act of 1970 ("RICO"), 18 U.S.C. §§ 1961-1968; The New Jersey Uniform Securities Law, N.J.S.A. 49:3-47, *et seq.*; The New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1, *et seq.*; and, applicable principles of common law.

2. Jurisdiction of this action is founded upon 7 U.S.C. § 25(c); 18 U.S.C. § 1964(c); 28 U.S.C. § 1331 ("Federal Question") and by virtue of this Court's pendant and ancillary jurisdiction over claims arising under state law

pursuant to 28 U.S.C. § 1367(a) because the state law claims are so related to the claims over which the Court has original jurisdiction that they form part of the same case or controversy. Service of Process outside the territorial limits of the District of New Jersey is made pursuant to 15 U.S.C. § 77v; 18 U.S.C. § 1965.

3. Venue is based upon 28 U.S.C. §§ 1391(b) and (c), and 18 U.S.C. § 1965(a) of RICO; in that the corporate and individual Defendants do business in this District, and the acts and transactions constituting the violations of law described in this Complaint, occurred in substantial part within the District of New Jersey.

4. In connection with the acts and conduct alleged within this Complaint the Defendants directly and indirectly used means and instrumentalities of interstate commerce, including the United States Mail, interstate and intrastate telephone communications, the facilities of various wire service systems for reporting commodities futures transactions, and interstate banking facilities.

PLAINTIFF CLASS REPRESENTATIVES

5. At all times pertinent hereto, the named Plaintiffs and proposed class representatives, Richard Nicholas and Lynn Nicholas ("Nicholas") who reside at 62 South Main Street, Cranbury, New Jersey 08512, and Robert M. Blackburn and Cheryl S. Blackburn ("Blackburn") who reside at 12 Hadley Drive, Cranbury, New Jersey 08512, were individual investors who delivered money to Charles "Chuck" Kohli ("Kohli"), Ram Chandran a/k/a Nungambukkam Swamy Ramachandran ("Chandran") and the Sigma Entities, as hereinafter defined, to be invested in commodity futures contracts through Defendants, Saul Stone & Company, LLC F/K/A Saul Stone And Company ("Saul Stone"), First Options of

Chicago, Inc. D/B/A LIT Division of First Options ("First Options"), Smith Barney, Inc. ("Smith Barney"), LFG, LLC F/K/A Linnco Futures Group, Inc. ("Linnco"), GNI Incorporated and GNI Limited (collectively "GNI"), Dean Witter Reynolds, Inc. ("Dean Witter"), ING (U.S.) Securities Futures & Options, Inc. D/B/A ING Futures & Options and F/K/A Quantum Financial Services, Inc., Internationale Nederlanden U.S. Derivatives Clearing, Inc., ING Securities Futures & Options, Inc. ("ING"), Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill"), Prudential Securities, Inc. ("Prudential"), Rosenthal Collins Group, L.P. F/K/A Rosenthal & Company ("Rosenthal"), E. D. & F. Man International, Inc. F/K/A E.D. & F. Man International Securities, Inc. ("E D & F"), and their respective agents, John Doe, Joan Doe, Jack Doe, Joseph Doe, Jane Doe, Jake Doe, Jeff Doe, Jean Doe, James Doe, Jill Doe, and Joel Doe. The dates and amounts of those investments, and all sums returned, for each named Plaintiff and proposed Class representative are as follows:

a. Nicholas initially deposited funds with Kohli, Chandran and the Sigma Entities, as hereinafter defined, from their IRA accounts, 401(K) pension funds and personal savings as follows:

Amount Invested	January 12, 1993	4,000.00
	May 1, 1993	8,000.00
	May 18, 1993	25,000.00
	January 4, 1994	10,000.00
	January 4, 1994	30,000.00
	August, 1994	125,000.00
Amount Returned		$ (39,000.00)
Net Loss		$ (163,000.00)

Nicholas lost all but $ 39,000.00 of their investment as well as improperly charged fees, $213,000.00 in purported profits and unexpected adverse tax consequences. Nicholas was required to file bankruptcy in the United States Bankruptcy Court for the District of New Jersey due to the aforesaid loss.

b. Blackburn initially deposited funds with Kohli, Chandran and the Sigma Entities, as hereinafter defined, from their IRA accounts, 401(K) pension funds and personal savings as follows:

Amount Invested	February 24, 1994	$106,306.39
	March 10, 1994	3,946.41
Amount Returned	April 12, 1995	$ (0.00)
Net Loss		$ (110,252.80)

Blackburn lost all of their investment as well as improperly charged fees, $133,468.65 in purported profits and unexpected adverse tax consequences.

DEFENDANTS

6. Upon information and belief, at all times pertinent to this Complaint, Saul Stone, was an Illinois corporation and is now an Illinois limited liability company, with its principal place of business at c/o Clarence Delbridge, III, 30 South Wacker Drive, Suite 1300, Chicago, Illinois 60606-7493; Saul Stone is registered with the Commodity Futures Trading Commission ("CFTC") under Section 4f of the CEA (7 U.S.C. § 6f) as a Futures Commission Merchant ("FCM"); Saul Stone is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; Saul Stone is a clearing member of commodity

exchanges, in particular the Chicago Mercantile Exchange ("CME"), its Designated Self Regulatory Organization ("DSRO"); Saul Stone is a member of the National Futures Association ("NFA") and at all times relevant hereto, Saul Stone transacted business in the State of New Jersey as a FCM for Plaintiffs.

7. Upon information and belief, and at all times pertinent to this Complaint, Defendant, John Doe was at all times alleged herein an employee and/or an agent of Defendant Saul Stone, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for Saul Stone, and was at all times alleged herein acting within the actual or apparent scope of his employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

8. Upon information and belief, at all times pertinent to this Complaint, First Options, was a Delaware corporation, with its principal place of business at One Financial Place, 440 South LaSalle Street, Chicago, Illinois 60606-1028; First Options is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; First Options is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; First Options is a clearing member of commodity exchanges, in particular the CME, its DSRO; First Options is a member of the NFA and at all times relevant hereto, First Options transacted business in the State of New Jersey as a FCM for Plaintiffs.

9. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Joan Doe was at all times alleged herein an employee and/or an agent of

Defendant First Options, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for First Options, and was at all times alleged herein acting within the actual or apparent scope of her employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

10. Upon information and belief, at all times pertinent to this Complaint, Smith Barney, was a Delaware corporation, with its principal place of business at 388 Greenwich Street, 8th Floor, New York, New York 10013; Smith Barney is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; Smith Barney is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; Smith Barney is a clearing member of commodity exchanges, in particular the Chicago Board of Trade ("CBOT"), its DSRO; Smith Barney is a member of the NFA and at all times relevant hereto, Smith Barney transacted business in the State of New Jersey as a FCM for Plaintiffs.

11. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Joseph Doe was at all times alleged herein an employee and/or an agent of Defendant Smith Barney, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for Smith Barney and was at all times alleged herein acting within the actual or apparent scope of his employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

12. Upon information and belief, at all times pertinent to this Complaint, Linnco, was an Illinois corporation and is now an Illinois limited liability company, with its principal place of business at 233 South Wacker Drive, Suite 2400, Chicago, Illinois 60606; Linnco is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; Linnco is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; Linnco is a clearing member of commodity exchanges, in particular the CME, its DSRO; Linnco is a member of the NFA and at all times relevant hereto, Linnco transacted business in the State of New Jersey as a FCM for Plaintiffs.

13. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Jane Doe was at all times alleged herein an employee and/or an agent of Defendant Linnco, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for Linnco and was at all times alleged herein acting within the actual or apparent scope of her employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

14. Upon information and belief, at all times pertinent to this Complaint, GNI, Inc. was an Illinois corporation, with its principal place of business at 30 South Wacker Drive, Suite 2009, Chicago, Illinois 60606; GNI Incorporated is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; GNI Incorporated is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; GNI is a clearing member of commodity exchanges, in

particular the CBOT, its DSRO; GNI Incorporated is a member of the NFA and at all times relevant hereto, GNI Incorporated transacted business in the State of New Jersey as a FCM for Plaintiffs.

15. Upon information and belief, at all times pertinent to this Complaint, Defendant, GNI Limited was a foreign broker within the meaning of 17 CFR Sections 15 through 17, with offices at Cannon Bridge, Fourth Floor, 25 Dowgate Hill, London, England EC4R 2GN; GNI Limited is in engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon.

16. GNI Incorporated and GNI Limited (collectively "GNI") are part of a group or family of companies that hold themselves out to the public and operate under the designation of GNI for all purposes, including, without limitation, advertising, initiating customer accounts, customer services, commodity reports, and annual financial reports. Upon information and belief GNI Incorporated trades futures contracts on a United States contract market as a FCM, the agent for GNI Limited. GNI Incorporated is the agent for GNI Limited for purposes of accepting delivery and service of any communication issued by or on behalf of the CFTC pursuant to 17 C.F.R. Section 15.05(b). GNI Limited is otherwise not registered with the CFTC nor the NFA, as an exempt foreign broker.

17. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Jake Doe was at all times alleged herein an employee and/or an agent of Defendant GNI, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission bro-

ker," and "introducing broker" for GNI and was at all times alleged herein acting within the actual or apparent scope of his employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

18. Upon information and belief, at all times pertinent to this Complaint, Dean Witter, was a Delaware corporation, with its principal place of business at 2 World Trade Center, New York, New York 10048; Dean Witter is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; Dean Witter is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; Dean Witter is a clearing member of commodity exchanges, in particular the CME, its DSRO; Dean Witter is a member of the NFA and at all times relevant hereto, Dean Witter transacted business in the State of New Jersey as a FCM for Plaintiffs.

19. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Jeff Doe was at all times alleged herein an employee and/or an agent of Defendant Dean Witter, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for Dean Witter and was at all times alleged herein acting within the actual or apparent scope of his employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

20. Upon information and belief, at all times pertinent to this Complaint, ING, was an Illinois corporation, with its principal place of business at 233 South Wacker Drive, Suite 5200 – Sears Tower, Chicago, Illinois

60606; ING is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; ING is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; ING is a clearing member of commodity exchanges, in particular the CBOT, its DSRO; ING is a member of the NFA and at all times relevant hereto, ING transacted business in the State of New Jersey as a FCM for Plaintiffs.

21. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Jean Doe was at all times alleged herein an employee and/or an agent of Defendant ING, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for ING and was at all times alleged herein acting within the actual or apparent scope of her employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

22. Upon information and belief, at all times pertinent to this Complaint, Merrill was a Delaware corporation, with its principal place of business at Merrill Lynch Headquarters, World Financial Center, 250 Vesey Street, New York, New York 10281; Merrill is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; Merrill is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; Merrill is a clearing member of commodity exchanges, in particular the CBOT, its DSRO; Merrill is a member of the NFA and at all times relevant hereto, Merrill transacted business in the State of New Jersey as a FCM for Plaintiffs.

23. Upon information and belief, and at all times pertinent to this Complaint, Defendant, James Doe was at all times alleged herein an employee and/or an agent of Defendant Merrill, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for Merrill and was at all times alleged herein acting within the actual or apparent scope of his employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2. George S. Bucknell solicited the account for Merrill on May 7, 1993.

24. Upon information and belief, at all times pertinent to this Complaint, Prudential, was a Delaware corporation, with its principal place of business at 1 Seaport Plaza, 199 Water Street, New York, New York 10292; Prudential is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; Prudential is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; Prudential is a clearing member of commodity exchanges, in particular the CBOT, its DSRO; Prudential is a member of the NFA and at all times relevant hereto, Prudential transacted business in the State of New Jersey as a FCM for Plaintiffs.

25. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Jill Doe was at all times alleged herein an employee and/or an agent of Defendant Prudential, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for Prudential and was at all times alleged herein acting within the actual or apparent scope of her employment and/or

agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

26. Upon information and belief, at all times pertinent to this Complaint, Rosenthal, was an Illinois corporation and is now an Illinois limited partnership, with its principal place of business at 216 West Jackson Boulevard, Suite 200, Chicago, Illinois 60606; Rosenthal is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a FCM; Rosenthal is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; Rosenthal is a clearing member of commodity exchanges, in particular the CME, its DSRO; Rosenthal is a member of the NFA and at all times relevant hereto, Rosenthal transacted business in the State of New Jersey as a FCM for Plaintiffs.

27. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Jill Doe was at all times alleged herein an employee and/or an agent of Defendant Rosenthal, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for Rosenthal and was at all times alleged herein acting within the actual or apparent scope of her employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

28. Upon information and belief, at all times pertinent to this Complaint, E D & F, was a Delaware corporation, with its principal place of business at Two World Financial Center, 225 Liberty Street, 27th Floor, New York, New York 10080-6127; E D & F is registered with the CFTC under Section 4f of the CEA (7 U.S.C. § 6f) as a

FCM; E D & F is engaged in, among other things, the business of brokerage in connection with the sale of commodities and commodity futures contracts, as well as options thereon; E D & F is a clearing member of commodity exchanges, in particular the CME, its DSRO; E D & F is a member of the NFA and at all times relevant hereto, E D & F transacted business in the State of New Jersey as a FCM for Plaintiffs.

29. Upon information and belief, and at all times pertinent to this Complaint, Defendant, Joel Doe was at all times alleged herein an employee and/or an agent of Defendant E D & F, acting at various times and simultaneously under the titles of "account executive," "registered representative," "associated person," "commission broker," and "introducing broker" for E D & F and was at all times alleged herein acting within the actual or apparent scope of his employment and/or agency at common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

30. The Defendants, Saul Stone, First Options, Smith Barney, Linnco, GNI, Dean Witter, ING, Merrill, Prudential, Rosenthal, and E D & F, each whom is registered with the CFTC as a FCM, are herein sometimes separately referred to as a "FCM" and sometimes collectively referred to as "FCMs."

31. The Defendants, John Doe, Joan Doe, Jack Doe, Joseph Doe, Jane Doe, Jake Doe, Jeff Doe, Jean Doe, James Doe, Jill Doe and Joel Doe, each of whom are employees of his or her respective Defendant FCM, are hereinafter sometimes collectively referred to as "FCM EMPLOYEES."

32. Clarence Delbridge, III ("Delbridge"), at all times pertinent to this Complaint, was a principal of and employed as a Vice-President of Saul Stone, a member

of the NFA as an Associated Person and elected to the Regional Business Conduct Committee of the NFA for the Central Region. Delbridge further acts as the NFA registration contact for Saul Stone.

33. Thomas H. Stone ("Stone"), at all times pertinent to this Complaint, was a principal and employed as Chairman of the Board of Saul Stone, a member of the NFA as a Floor Broker (which may act in the capacity of an Associated Person) and elected to the Advisory Committee of the NFA for Futures Commission Merchants.

34. The NFA is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business at 200 West Madison Street, Suite 1600, Chicago, Illinois 60606-3447 and a regional office at 120 Broadway, Suite 1125, New York, New York 10271. The NFA is a Registered Futures Association pursuant to 7 U.S.C. § 17 of the CEA; and at all times relevant hereto, transacted business in the State of New Jersey as the futures industry's self-regulatory organization, entirely financed by the futures industry. No person or firm may engage in any business which involves buying or selling futures contracts for the public without being an NFA member.

NONPARTY CO-CONSPIRATORS

35. Sigma, Inc. ("Sigma") is a Delaware corporation that was engaged in soliciting, pooling and investing client's funds in the securities and commodities futures and options markets. It had its principal offices located at 101 Carnegie Center, Suite 203, Princeton, New Jersey 08540.

36. Kohli, an individual, who, during the relevant period of time, resided in Princeton, Mercer County, New Jersey, solicited investments for and delivered investments for the FCMs, directly and indirectly through FCM EMPLOYEES, to be processed and traded, and conspired with the FCMs and the FCM EMPLOYEES in the manner hereinafter described in detail. Kohli was not registered as a commodity trading advisor ("CTA"), a commodity pool operator ("CPO"), Introducing Broker ("IB") nor an associated person ("AP") pursuant to the CEA, CFTC regulations and the NFA Articles of Incorporation, By Laws, Compliance Rules, Financial Requirements and Registration Requirements (hereinafter referred to collectively as the "NFA Manual") from January 1, 1989 through April 12, 1995. At all relevant times, Kohli was one (1) of two (2) directors and a principal officer of the Sigma Entities, as hereinafter defined.

37. Kohli pleaded guilty to five (5) counts of federal criminal charges, one (1) count in connection with sales of commodity futures, including a charge of commodities fraud on March 6, 1996 for, *inter alia*, his activities alleged in this Complaint. More specifically, Kohli pleaded guilty to five (5) of six (6) counts as set forth in the Information filed with this Court by the United States Attorney on March 6, 1996 under *United States of America v. Chuckles Kohli a/k/a Chuck Kohli*, Criminal No. 96-132 (AET) ("Kohli Criminal Action"), a copy of which is attached hereto as Exhibit "A" and incorporated herein by this reference. On July 17, 1996 Kohli was sentenced to seventy-five (75) months imprisonment by U.S. District Court Judge Anne E. Thompson. Further, as of November 14, 1996 Kohli and the Receiver entered into a Settlement Agreement subject to the approval of this Court, wherein Kohli agreed to a judgment in the

amount of $30,000,000.00, together with the transfer of all assets in his control and a representation by way of Kohli's personal financial statement, that he has no other assets. As such, the pursuit of the claims against Kohli would be illusory, and therefore he is not named as defendant in this action.

38. Chandran is a resident of Lawrence Township, Mercer County, New Jersey, who solicited investments for and delivered investments to the FCMs, directly and indirectly through FCM EMPLOYEES, to be processed and traded, and conspired with the FCMs and the FCM EMPLOYEES in the manner hereinafter described in detail. Chandran was not registered as a CTA, CPO, IB nor an AP pursuant to the CEA, CFTC regulations and the NFA Manual from January 1, 1989 through April 12, 1995. At all relevant times, Chandran was one (1) of two (2) directors and a principal officer of the Sigma Entities, as hereinafter defined. Chandran has filed bankruptcy in the United States Bankruptcy Court for the District of New Jersey under Case No. 96-36569(WHG). Accordingly, Chandran is not named as a defendant in this action, as the automatic stay is in effect under 11 U.S.C. § 362.

39. All acts, omissions, knowledge or intent ascribed in this Complaint to Kohli, Chandran and/or Sigma Entities are hereby alleged to have been known, or but for reckless disregard for the truth and in bad faith, should have been known by the Defendants, FCMs, FCM EMPLOYEES, Delbridge, Stone and the NFA.

40. All acts, omissions, knowledge or intent ascribed in this Complaint to Defendants FCMs, FCM EMPLOYEES, Delbridge and Stone are hereby alleged to have been known, or but for reckless disregard for the truth and in bad faith, should have been known by the NFA.

RELEVANT NONPARTY

41. John L. Manley ("Manley") having his offices c/o Deliotte & Touche LLP, 2 Hilton Court, Parsipanny, New Jersey 07054, was appointed on April 24, 1995 as Permanent Equity Receiver (the "Receiver") for the Sigma Entities, as hereinafter defined, and other affiliated businesses, by the "Order Appointing Equity Receiver" issued by the United States District Court for the District of New Jersey in a matter captioned, *Commodity Futures Trading Commission v. Sigma Inc., Chuck Kohli and N.S. Ramachandran a/k/a Ram Chandran*, Civil Action No. 95-1598(AET) ("Sigma Civil Action").

42. A Report of the Receiver dated October 5, 1995 and filed on October 10, 1995 with the United States District Court, District of New Jersey, Sigma Civil Action indicates that Sigma has neither assets nor any real net worth. As such, and due to Sigma's receivership status, Sigma nor any of the other Sigma Entities are named as Defendants in this Complaint.

43. The Plaintiffs have relied to this point on the Receiver and his pursuit of assets on behalf of Sigma for the benefit of the Plaintiffs. The Receiver provided status reports of his efforts to the Plaintiffs on a regular basis. It was not until the recent proposed Settlement Agreement of November 14, 1996 with Kohli that the Plaintiffs realized they are no longer able to depend on the Receiver to pursue claims on behalf of the Plaintiffs. As such, the filing of this Complaint is a necessary course of action.

PLAINTIFF CLASS ALLEGATIONS

44. The named Plaintiffs bring this action and these allegations as a Class Action pursuant to Rule 23 of the Federal Rules of Civil Procedure on behalf of a Plaintiff Class consisting of all persons who delivered money to Kohli and Chandran for investment with the Sigma Entities, as hereinafter defined, in commodity futures contracts during the period from January 1, 1989 through April 12, 1995, inclusive (the "Class Period"), excluding Defendants and excluding all persons who received from Kohli and Chandran payments equal to or exceeding the amount of that person's investment with Kohli and Chandran, as well as the principals of any of the Sigma Entities.

45. Approximately $68,000,000.00 was delivered to Kohli, Chandran and the Sigma Entities during the Class Period for investment by approximately 400 persons with the reasonable expectation that Kohli, Chandran and the Sigma Entities were operating in a lawful manner, were holding all licenses and registrations necessary to conduct their business, and were operating under standards established by the appropriate state and Federal regulatory agencies. Accordingly, the Plaintiff Class members are so numerous that joinder of all members is impracticable, if not impossible. The exact number of Class members is unknown to Plaintiffs at this time, but can be ascertained through the records of Kohli, Chandran, Sigma Entities and by discovery.

46. There are questions of law and fact common to the above described Class. Such common questions as to all members of the Plaintiff Class predominate over any questions solely affecting individual members of the Plaintiff Class. Among the questions of law and fact common to the Plaintiff Class are:

(a) Whether the CEA and the CFTC regulations were violated by the Defendants' acts or omissions as alleged herein;

(b) Whether the NFA Manual was violated by the Defendants' acts or omissions as alleged herein;

(c) Whether the Federal Securities and Racketeering Laws were violated by the Defendants' acts or omissions as alleged herein;

(d) Whether Defendants participated in and pursued the conspiracy and common course of conduct alleged herein;

(e) Whether Defendants aided or abetted the commission of criminal, willful, reckless, grossly negligent or negligent acts or omissions concerning the nature of the investments for which the money of the Plaintiff Class members were solicited and obtained;

(f) Whether Defendants owed a fiduciary duty to the members of the Plaintiff Class and, if so, whether that duty was violated by the conduct alleged herein;

(g) Whether Defendants, Delbridge, Stone and NFA acted in bad faith and/or with reckless disregard in failing to enforce the NFA Manual;

(h) The nature and extent of Defendants' actual knowledge of the investment practices of Kohli, Chandran and the Sigma Entities;

(i) Whether Defendants FCMs owed a duty to the general public and the Plaintiff Class to diligently manage, supervise, and investigate the activities and train its personnel FCM

EMPLOYEES to insure that they operated in compliance with the law and CEA and CFTC regulations;

(j) Whether Defendants FCMs owed a duty to the general public and the Plaintiff Class to diligently manage, supervise, and investigate the activities and train its personnel FCM EMPLOYEES to insure that they operated in compliance with the NFA Manual;

(k) Whether Defendants, Delbridge, Stone and NFA owed a duty to the general public and the Plaintiff Class, to act without bad faith while diligently supervising, investigating and disciplining the activities of its members, FCMs and FCM EMPLOYEES to insure that they were doing business with Members of the NFA and that they operated in compliance with the law and CEA, CFTC regulations and the NFA Manual;

(l) Whether Defendants, Delbridge, Stone and NFA owed a duty to the general public and the Plaintiff Class, to act without bad faith while diligently supervising, investigating and disciplining the activities of Kohli, Chandran and the Sigma Entities to insure that they operated in compliance with the law, the CEA, CFTC regulations and the NFA Manual; and,

(m) Whether the Plaintiff Class members have remedies under state law.

47. The claims of the named Plaintiffs, as asserted herein, are typical of the claims of the above described Plaintiff Class. There do not exist any disabling conflicts

among Plaintiff Class members regarding the subject matter of this litigation.

48. The named Plaintiffs will fairly and adequately protect the interests of the above described Plaintiff Class. Plaintiffs have retained counsel competent and experienced in claims of the nature alleged herein.

49. Plaintiffs were informed by Kohli that he and Chandran would act as their agents, either directly or through one or more of the Sigma Entities.

50. A Class Action is superior to other available means for the fair and efficient adjudication of this controversy, since joinder of all members is impracticable. Furthermore, since the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation of a case of this magnitude makes it impossible for Plaintiff Class members, individually, to redress the wrongs done to them, and therefore requires concentration of all such claims in one forum. There will be no significant difficulty in the management of this action as a Plaintiff Class action. The membership of the above described Plaintiff Class does not have any interest in individually controlling the prosecution of separate actions against Defendants as opposed to treatment of these actions as a Class Action.

FACTUAL BACKGROUND

51. Since 1989, Kohli and Chandran, have solicited funds from members of the public, including the Plaintiffs, to invest in commodities for future delivery (pursuant to 7 U.S.C. § 7), options on commodities (pursuant to 7 U.S.C. § 6c) and other commodities, futures contracts and commodity options, including options not traded on a national exchange through commodity pools.

Kohli and Chandran used the business names of Sigma, Inc. ("Sigma"), Geronimo, Inc. a/k/a Geronimo Group ("Geronimo"), Vol Partners, L.P. ("Vol") and Savid Group ("Savid") through which all their solicited business was conducted for the so-called commodity pools (hereinbefore and hereinafter collectively referred to as the "Sigma Entities").

52. Plaintiffs were informed by Kohli that he and Chandran would act as their agents, either directly or through one more of the Sigma Entities.

53. The Plaintiffs signed Powers of Attorney attached hereto as Exhibit "B," giving Kohli, Chandran and the Sigma Entities discretionary authority over investing funds and trading decisions in order to act on behalf of the Plaintiffs as their agents with the FCMs. Neither Kohli, Chandran nor the Sigma Entities delivered to Plaintiffs a Disclosure Document pursuant to 17 C.F.R. Section 4.21 and NFA Compliance Rule 2-13 and in the form required by 17 C.F.R. Section 4.21. The Plaintiffs did not provide Kohli, Chandran nor the Sigma Entities with a written receipt for any such Disclosure Documents, nor were the Plaintiffs requested to do so.

54. Plaintiffs were informed their funds would be pooled and used to trade in the currency markets, and in other markets. For example, as described by Kohli and Chandran in Sigma's promotional materials, the Currency Derivative Portfolio "replicates investment in underlying currencies through currency options." In similar fashion, Kohli and Chandran through Sigma and Vol, purported to trade Plaintiffs' funds in "index options, foreign currencies and currency options."

55. Because of the business activities in which they engaged, Kohli, Chandran and the Sigma Entities were required by Federal and New Jersey laws to register with

the CFTC, the Securities and Exchange Commission, the New Jersey Bureau of Securities and to become members of the NFA. They never registered with, or became members of, any of those regulatory or self-regulatory authorities.

56. During the Class Period Kohli and Chandran sold rights to participate in at least one partnership, Vol, and through Sigma, various portfolios for the purpose of investing pools funded in foreign currencies traded on exchanges, futures and options in foreign currencies traded on commodity and security exchanges, index options and other securities and commodities.

57. In its promotional materials, Kohli and Chandran claimed to have more than $260,000,000.00 under "advisory management" in its various commodity pools. Plaintiffs were told that, from 1990 to 1994, Kohli and Chandran, through Sigma's commodity pools, had annual rates of return ranging from 14.58 to 102.01 percent.

58. Since at least 1992, monthly reports issued by Kohli and Chandran, through the Sigma Entities, to the Plaintiffs who invested in its various commodity pools have rarely, if ever, reflected any losses. The purported profits were entirely fictitious.

59. When early investors sought to withdraw their funds or their purported profits, Kohli and Chandran paid them from funds invested by subsequent investors. Such fraudulent activity is commonly referred to as a " "Ponzi" scheme.

60. Upon information and belief, as of February 28, 1995, reports issued by Kohli and Chandran, through the Sigma Entities, to Plaintiffs showed, in the aggregate, that the commodity pools operated by Kohli and

Chandran had assets totalling at least $68,000,000.00. Of this amount, approximately $55,000,000.00 was lost through trading activities. Additionally, $5,000,000.00 was spent by Kohli, Chandran and the Sigma Entities and $11,600,000.00 was returned to investors.

61. Upon information and belief, Kohli, Chandran and the Sigma Entities used part of the $5,000,000.00 to entertain FCM EMPLOYEES, in particular, without limitation, APs of Merrill, in December, 1994 at a Florida golf trip sponsored by the Sigma Entities and APs of First Options at golf outings, football games and various parties in either New Jersey or Las Vegas in 1994.

62. Upon information and belief, some of the investors' funds were use to pay for personal trips to Florida, among other places, by at least one FCM EMPLOYEE (and his family), Steve Kaczmer ("Kaczmer"), who was employed first by Defendant Linnco (which held 10 accounts on behalf of the Plaintiffs by way of the Sigma Entities) and then by the Defendant First Options (which held 23 accounts on behalf of the Plaintiffs by way of the Sigma Entities).

63. Upon information and belief, certain of the investors' funds were also used to pay $10,000.00 per month salary to Kaczmer who, while trading during the day at First Options, traded at night for the Sigma Entities from his home terminal. The operating expenses for this arrangement were paid by Kohli from a bank account(s) in one or more of the Sigma Entities' names. That same FCM employee also received from Kohli the sum of $60,000.00 in the form of a "loan" for improvements to his home, only $40,000.00 of which was repaid. The balance of the loan was "forgiven" by Kohli.

64. Sometime between approximately January 1, 1989 and April 12, 1995 Kohli, Chandran and the Sigma

Entities, none of whom were registered with the CFTC nor the NFA, approached the Defendants FCMs to place all orders to purchase or sell futures contracts through said Defendants, each of whom were then and continue to be registered as a FCM pursuant to the CEA 7 U.S.C. § 6f and a member of the NFA. All orders to purchase or sell futures contracts with the funds solicited by Kohli, Chandran and the Sigma Entities would be placed directly through the Defendants FCMs or in the alternative, indirectly through FCM EMPLOYEES of their respective FCMs.

65. Once Kohli, Chandran and the Sigma Entities secured the initial core of Plaintiff investors, they induced additional persons to invest through the Sigma Entities' false appearance of legitimacy. The appearance of legitimacy stemmed from the fact that although only a properly registered and licensed FCM or CPO may hold customers' money in an omnibus account (an account with a clearing member firm of an exchange, like the Chicago Board of Trade, opened for the purpose of holding other people's money for trading commodities by a non-member broker), the FCMs allowed the Sigma Entities to deposit customers' funds in an account with the FCMs even though they were not registered as an FCM or a CPO. The FCMs treated all of the accounts of the Sigma Entities as one omnibus account managed by Kohli and Chandran.

66. Once Kohli, Chandran and the Sigma Entities created the false appearance that the Sigma Entities held large sums of money, were profitable and legitimate, the false appearance spread by word of mouth from current investors to their friends and relatives.

67. The following account numbers of Kohli, Chandran and the Sigma Entities, identified with each of the

following Defendants (signed only by Kohli and Chandran and designated as a Special Account), are as follows:

Defendant (FCM)	Statement Period	Account Name	Account Number
Saul Stone:	02/91 - 06/93	Sigma	18126
	10/94 - 05/95	Sigma	18126
	07/91 - 05/95	Geronimo	18127
	07/91 - 03/95	Geronimo	18125
	12/91 - 03/95	Geronimo	18124
First	01/94 - 07/94	Geronimo	1 GR
Options:	07/93 - 04/95	Geronimo	9 GR
	08/94 - 12/94	Geronimo	90087 SCROT
	06/94 - 04/95	Geronimo	90087 SCROT
	01/93 - 04/95	Geronimo	90087 GRNM1
	08/92 - 04/95	Geronimo	90087 GRNMO
	08/92 - 04/95	Sigma	90069 SIGMA
	03/94 - 03/94	Sigma	SIGM2
	03/94 - 03/94	Sigma	SCREW
	03/94 - 04/95	Sigma	90069 NAILS
	01/94 - 03/94	Sigma	90069 SIGM1
	03/94 - 04/95	Sigma	90069 ELWOD
	01/93 - 04/95	Geronimo	90087 GRNM2
	04/93 - 04/95	Geronimo	90087 GRNM3
	06/94 - 04/95	Geronimo	90087 CAPUT
	07/94 - 03/95	Geronimo	90087 GRNMO
	06/93 - 05/94	Geronimo	90087 GRNMO
	08/93 - 05/94	Geronimo	90087 GRNMO
	05/93 - 05/94	Geronimo	90087 GRNMO
	09/93 - 05/94	Geronimo	90087 GRNMO
	10/93 - 05/94	Geronimo	90087 GRNMO
	08/92 - 07/93	Sigma	30073288
	09/92 - 07/93	Geronimo	30034664

Defendant (FCM)	Statement Period	Account Name	Account Number
Smith Barney:	11/92 - 08/93	Geronimo	01k-476226
	10/92 - 03/93	Geronimo	01k-476196
	10/92 - 03/93	Geronimo	01k-476196
	11/92 - 07/93	Geronimo	016-476234
Linnco:	06/93 - 09/93	Sigma	181 18204
	06/93 - 12/93	Geronimo	181 18205
	04/94 - 06/94	Geronimo	181 18205
	06/93 - 09/93	Geronimo	181 18208
	04/94 - 06/94	Geronimo	181 18208
	06/94 - 06/94	Geronimo	181 18206
	06/94 - 06/94	Geronimo	181 18207
	06/94 - 06/94	Geronimo	181 18205 non-regulated
	06/94 - 06/94	Geronimo	181 18205
	06/94 - 06/94	Geronimo	181 18205
GNI:	03/95 - 05/95	Geronimo	GERO/X I1H J BN
	06/94 - 04/95	Geronimo	GERONIMO USD
	06/94 - 05/95	Geronimo	GERO/X I1H J BN
	06/94 - 04/95	Geronimo	GERONIMO DM
	06/94 - 05/95	Geronimo	GERO/X I1H J BN
	06/94 - 04/95	Geronimo	APACHE/Q 32 K B
	06/94 - 04/95	Geronimo	APACHE/Q 32 K B
	06/94 - 04/95	Geronimo	APACHE/Q 32 K B
	06/94 - 04/95	Geronimo	APACHE/Q 32 K B
	06/94 - 04/95	Geronimo	APACHE/Q 32 K B
	12/94 - 04/95	Geronimo	APACHE/Q 32 K B
	12/94 - 04/95	Geronimo	APACHE/Q 32 K B
	03/95 - 03/95	BTB Group Ltd. (Kohli)	BTBX/X I1H J BN
Dean Witter:	10/94 - 06/95	Geronimo	237-069460
	07/94 - 12/94	Geronimo	69460

Defendant (FCM)	Statement Period	Account Name	Account Number
ING:	05/93 - 05/95	Geronimo	02550
	06/93 - 08/93	Geronimo	25153: seg funds
	07/93 - 09/93	Geronimo	25153: non seg funds
	07/93 - 09/93	Geronimo	25153: BP
	08/93 - 08/93	Geronimo	25153: FF
	07/93 - 08/93	Geronimo	25154: seg funds
Merrill:	07/94 - 12/94	Geronimo	877 48584R
	05/93 - 09/93	Geronimo	713 07D92
	10/93 - 05/95	Geronimo	877 07S19
Prudential:	08/92 - 11/94	Sigma	ABT 960274 NSeg
	04/92 - 11/94	Geronimo	ABT 959861
	08/92 - 11/94	Sigma	ABT 960274 Seg
	06/92 - 11/94	Geronimo	ABT 960207
	08/91 - 01/93	Sigma	ONS-96770-13
	01/92 - 03/93	Geronimo	ONS-968021-13
	07/92 - 09/92	Sigma	ONS-968358-13
	07/92 - 10/92	Sigma	ABT-960274-08
	07/92 - 05/94	Geronimo	ABT-960207-08
Rosenthal:	03/95 - 04/95	Geronimo	85 85920
E D & F:	05/93 - 07/93	Geronimo	C DEC 47526

The accounts were to be used as a pooled repository for funds solicited by Kohli and Chandran. Any profits earned through trading in the aforesaid accounts, were in turn to be split between the solicited investors, on the one hand and Kohli, Chandran and the Sigma Entities on the other hand.

68. At all times pertinent hereto, Defendants FCMs opened Special Accounts for investment in commodities, for future delivery and/or options on commodities for

Kohli and Chandran, through business names of Sigma, Inc., Geronimo, Inc. a/k/a Geronimo Group, Vol Partners, L. P. and Savid Group, as Third Party Account Controllers without CFTC registration and NFA membership.

69. Upon information and belief, the Special Accounts which were opened at the Defendants FCMs were all corporate and/or partnership accounts whose forms were completed by Kohli. In connection with opening a new account, the FCMs would have and should have required the Sigma Entities to submit certain documentation and information, including financial statements and/or information of the principals of the company as well as certification indicating who from the company was authorized to conduct trades and transfers of money in and out of the account, which they failed to so do.

70. Upon information and belief, the financial information which Kohli provided to the FCMs on the account forms was inconsistent with the magnitude of the trading activity conducted in the accounts and the substantial losses sustained in the accounts over the relevant period. Indeed, upon information and belief, the volume of trading and the trading losses as sustained in the accounts frequently exceeded the equity in the accounts and the net worth of the Sigma Entities as shown on the financial information submitted to the defendants FCMs.

71. In light of the material discrepancies between the reported financial information of the Sigma Entities, the volume of trading conducted in the accounts, the substantial losses which were being sustained in the accounts and the number of different individuals who were listed with trading authority on the accounts

(Kohli, Chandran, Dan Johnson, Dave Lan, Bob McMahon, Anthony Caputo, Steve Redler, Mike Knesivitch, Eric Robertson), Defendants FCMs were aware that the accounts were being operated as commodity pools comprised of funds solicited from third party investors, therefore requiring registration pursuant to CFTC regulations and NFA Rules. The actions of the FCMs were reckless and without regard for the truth. The FCMs failed to perform minimal due diligence with regard to the background of Kohli, Chandran and the Sigma Entities.

72. Kohli, Chandran and the Sigma Entities, all Third Party Account Controllers, with discretion over the accounts of the Plaintiffs, neither registered with the CFTC as a CPO pursuant to 7 U.S.C. Section 6n., 17 CFR Section 4.1*et seq.*, nor properly claimed exemption from registration as a CPO. Kohli, Chandran and the Sigma Entities failed to deliver to Plaintiffs a written statement, describing, among other things, the exemption pursuant to 17 CFR § 4.13 (the "Written Statement") and failed to file copies of the Written Statement with the CFTC and the NFA.

73. Upon information and belief, some of the funds in the Sigma Entities' Special Accounts at certain of the Defendants FCMs were improperly transferred by these Defendants FCMs, upon instructions from Kohli, to personal accounts maintained by Kohli, individually and/or jointly with his then wife. In the aggregate these transfers totalled at least $710,000.00.

74. Specifically, and as part of the wrongful conversion of the funds in the Special Accounts of the Sigma Entities to Kohli and/or his then wife, a total of $590,000.00 was transferred from at least on account in the name of Geronimo at Merrill to Kohli's personal

account at Charles Schwab & Co., Inc. ("Schwab") or Dean Witter.

75. In addition, and as part of the wrongful conversion of the funds in a Merrill account in the name of Geronimo, $80,000.00 was transferred from that account to Kohli's personal joint account with his then wife, at Schwab.

76. Specifically, and as part of the wrongful conversion of the funds in a Prudential account in the name of Sigma, $40,000.00 was transferred from that account to Kohli's personal joint account with his then wife, at Schwab.

77. Upon information and belief, the Defendants, FCMs and FCM EMPLOYEES never received an acknowledgment from the Plaintiffs for receipt of the required Disclosure Document pursuant to 17 CFR § 4.24 from Kohli, Chandran and the Sigma Entities, nor the Written Statement from Kohli, Chandran and the Sigma Entities explaining why a Disclosure Document is not required pursuant to NFA Compliance Rule 2-8(e).

78. Upon information and belief, the Defendants, FCMs and FCM EMPLOYEES failed to verify whether Kohli, Chandran and the Sigma Entities made the required filings of the Written Statement of exemption pursuant to 17 CFR § 4.13.

79. Upon information and belief, Defendants, FCMs and FCM EMPLOYEES did not confirm delivery of the required Disclosure Document by the Third Party Account Controllers, Kohli, Chandran and the Sigma Entities to the Plaintiffs pursuant to 17 CFR § 4.21 of the CFTC regulations and NFA Compliance Rule 2-13.

80. Upon information and belief, and at all times pertinent to this Complaint, Defendants, FCMs and FCM EMPLOYEES made a practice of opening Special Accounts for and over which Kohli and Chandran, under the business names of the Sigma Entities, exercised discretion as Third Party Account Controllers, neither making inquiry as to the financial condition of Kohli, Chandran and the Sigma Entities nor inquiry as to the source of funds deposited into those accounts and status of the CFTC registration and the NFA membership of Kohli, Chandran and the Sigma Entities.

81. The Defendants, FCMs and FCM EMPLOYEES failed to investigate and know their customer. Upon information and belief the aforesaid Defendants failed to perform minimum due diligence by not contacting the CFTC and the NFA to gather information regarding Kohli, Chandran and the Sigma Entities as the agents for the Plaintiffs and pursuant to NFA Compliance Rule 2-8(e).

82. At all times pertinent to this Complaint, Defendants, FCMs and FCM EMPLOYEES violated NFA Articles of Incorporation, Article III, § 1(f) and NFA Bylaw 1101 by carrying accounts, accepting and handling transactions in commodity futures contracts on behalf of the Sigma Entities, non-Members of the NFA who were required to be registered with the CFTC and to refrain from transacting business with an unregistered person pursuant to the statutory makeup of 7 U.S.C. Sections 6d., 6e., 6k. and 6n.

83. Upon information and belief, Defendants, FCMs and FCM EMPLOYEES did not deliver to Plaintiffs the required Disclosure Document in the form mandated by 17 CFR 1.55 pursuant to 17 CFR 1.55 and NFA Compliance Rule 2-26.

84. During the Class Period, the Sigma Entities' accounts collectively indicated a value of approximately $68,000,000.00 as of February 28, 1995. As of April 12, 1995, the accounts collectively had lost all of their equity, due to the trades of Kohli and Chandran who were the individuals responsible for the accounts according to the account records held by Defendants, FCMs. All of this activity resulted from trades made by Kohli and Chandran with funds solicited from third party investors, the Plaintiffs, by Kohli and Chandran. All daily and monthly trading statements for the Sigma Entities accounts were sent directly to Kohli's offices at Sigma, Inc. at 101 Carnegie Center, Suite 203 Princeton, New Jersey 08540. The Defendants FCMs did not deliver monthly trading statements to the Plaintiffs.

85. At various times, the accounts of Kohli and Chandran, under the business names of the Sigma Entities, carried lower balances with Defendants, FCMs (separately and collectively) than necessary to meet the withdrawal demands of the Plaintiffs. At various times, the accounts of the Sigma Entities carried negative balances. As such, Kohli and Chandran had to solicit additional funds from new investors so that the new investors' money could be placed in the accounts, all the time concealing from the Plaintiffs the true status of their accounts, which had, experienced enormous diminution in their values.

86. Defendants, FCMs, FCM EMPLOYEES, Delbridge and Stone knew or should have known that most of the funds in the accounts of the Sigma Entities during the period of January 1, 1989 through April 12, 1995 had been obtained by Kohli and Chandran from third party investors, the Plaintiffs, by false pretenses and without proper regard to the requirements of the CEA, CFTC Regulations and the NFA Manual concerning commod-

ity pool investments, all as set forth with particularity in the complaints on file with this Court in the Sigma Civil Action and the Kohli Criminal Action, Exhibit "A" attached hereto.

87. During the period from January 1, 1989 through March 1, 1995 Defendants, FCM and FCM EMPLOYEES knew, or should have known, that the accounts of the Sigma Entities contained funds belonging to investors, as principals, other than Kohli and Chandran.

88. Defendants, FCMs, FCM EMPLOYEES, Delbridge and Stone knew, or had reason to believe, that the funds that Kohli, Chandran and the Sigma Entities were soliciting were coming from the Plaintiff Class members, who were innocent investors, who believed their money was being pooled legally and properly invested in the commodities market, through their agents, Kohli, Chandran and the Sigma Entities.

89. Commencing on or after January 1, 1989, Kohli, Chandran and the Sigma Entities did knowingly, with the intent to deceive, or with reckless disregard for the truth or falsity of the statements they made and would make, solicit funds for investment in the commodities market from the Plaintiffs who constitute the Class herein, by making false and misleading statements of material facts to them, *inter alia*, substantially as follows:

(a) That Plaintiff Class members' funds would be invested in the commodities market in a pooled account, but in a thoroughly legal way;

(b) That Plaintiff Class members would either not be subject to any risk of loss or the least possible risk;

(c) That any profits earned in the account would be split 75% to the Plaintiff Class members and

25% to Kohli, Chandran and the Sigma Entities;

(d) When asked, Kohli and Chandran would tell the Plaintiff Class members that past experience showed a rate of return of approximately 14.58% to 102.12% of funds invested;

(e) That they, Kohli, Chandran and the Sigma Entities, were very experienced in the commodity futures market and would give them monthly accountings;

(f) That Plaintiff Class members could take their money out of the commodities market at any time upon thirty (30) or ninety (90)days notice, as the case may be;

(g) That Kohli, Chandran and the Sigma Entities used large, well established brokerage houses as their clearing agents and that they maintained huge accounts with the Defendants FCMs; and,

(h) Investors', other than Plaintiffs, prior investment(s) with Kohli, Chandran and the Sigma Entities had earned substantial profits as shown by the accounting which Kohli and Chandran had provided the Plaintiffs.

90. In addition, Kohli, Chandran, FCMs, FCM EMPLOYEES, Delbridge, Stone, and the NFA knowingly, with intent to deceive, with reckless disregard for the truth or conscious avoidance of the truth, in bad faith, withheld and/or failed to disclose to Plaintiff investors, *inter alia*, the following:

(a) That Kohli, Chandran and the Sigma Entities were not registered and/or licensed CPO or in

any other respect licensed to trade commodity futures contracts for third parties, although they were required to be so licensed, if engaged in trading commodity futures for the Plaintiffs;

(b) That Kohli, Chandran and the Sigma Entities were not members of the NFA in any capacity;

(c) That Kohli, Chandran and the Sigma Entities were not registered and/or licensed under either state or Federal laws or regulations as a securities dealer, broker or other person permitted to sell securities to third parties;

(d) That the securities solicited and sold to Plaintiff Class members were not registered as securities under either state or Federal laws or regulations;

(e) That Kohli and Chandran were not investing all funds obtained from the Plaintiffs in commodity futures contracts or other legitimate investments, but were also using said funds to pay phony "profits" and for other business and personal purposes;

(f) That Defendants, FCMs and FCM EMPLOYEES earned commissions on every commodity futures contract trade made through FCMs;

(g) That Defendants, FCMs had not followed the rules and regulations of the CFTC and the NFA Manual concerning disclosure of information as required to be made to third-party investors;

(h) That some of Plaintiff investors' funds were going to repay Defendants, FCMs for debit balances in the accounts;

(i) That Kohli and Chandran had very little, or no knowledge, about commodity futures contract trading and very little or no experience as an investor in commodity futures contracts;

(j) That Kohli and Chandran were not keeping or maintaining accurate and complete records of the handling of all sums received from members of the Plaintiff Class and/or funds invested in commodity futures contracts;

(k) In investing and managing the Plaintiffs' funds, Kohli, Chandran and the Sigma Entities had not followed the rules and regulations of the CFTC and the NFA Manual concerning the operations of such pools, the disclosures required to be made to pool participants, the records that must be made and kept by pool operators, and the availability of such records to third-party investors;

(l) Most, or all of the accounting and other statements which Kohli, Chandran and the Sigma Entities had made to the Plaintiffs, had reflected fictitious profits and equities, and other false and misleading information as to material matters of fact;

(m) Kohli, Chandran and the Sigma Entities were becoming more and more deeply indebted to the Plaintiffs as a result of their misuse of the funds entrusted to them for investment purposes; and,

(n) Kohli, Chandran and the Sigma Entities had never earned any annual net income for the Plaintiffs on a consolidated basis through their investment of funds obtained from them.

91. During the Class Period, Kohli, Chandran and the Sigma Entities solicited funds from the Plaintiff Class members in the approximate sum of $66,600,000.00. Unbeknownst to any of the Plaintiff Class members, Kohli, Chandran and the Sigma Entities actually invested less than the full amount solicited, directly with the FCMs in the commodities market; the remainder of the funds (a) went to other investments, (b) were returned to other investors as phony "profits," or (c) were diverted to Kohli's and Chandran's personal use in ways that did not benefit Plaintiff Class members. In actuality, Kohli's and Chandran's investment program turned out to be a "Ponzi" scheme, a fact which was known or should have been known in the exercise of reasonable care, and due diligence by the Defendants, FCMs, FCM EMPLOYEES, Delbridge and Stone. Of the $66,600,000.00 invested, approximately $11,600,000.00 was returned to the Plaintiff Class members by Kohli and Chandran as alleged "profits" on their investments or return of capital.

92. During March, 1995 and prior to April 12, 1995, Plaintiffs attempting to withdraw funds from Kohli, Chandran and the Sigma Entities were unable to do so. On April 12, 1995, without prior notice to customers, Kohli, Chandran and the Sigma Entities ceased business operations and closed their offices. Upon information and belief, there is approximately $273,160.34 held by the Receiver.

93. In September 1982, Defendant, Saul Stone had received actual notice of a similar "Ponzi" scheme of fraud and deceitful practices perpetrated through, and with the assistance of Saul Stone's offices and personnel. Said fraudulent practices took place primarily in the State of Illinois, beginning in 1980 through the activities of Robert B. Serhant and others named as defendants

therein, including Saul Stone, and are more particularly set forth in a complaint filed in the United States District Court for the Northern District of Illinois under No. 82-C-6611. This put Saul Stone on notice, as to the likelihood and foreseeability of such "Ponzi" schemes developing, when it did not diligently supervise the activities of its personnel and APs and when it did not comply with the rules and regulations of the CFTC, CME and NFA Manual.

94. In June 1985, Defendant, Saul Stone had also received actual notice of a similar "Ponzi" scheme of fraud and deceitful practices perpetrated through, and with the assistance of Saul Stone's offices and personnel. Said fraudulent practices took place primarily in the State of Washington, beginning in May 1980 through the activities of Bonnie Frost and others, with Saul Stone named as a Defendant therein, and are more particularly set forth in a complaint filed in the United States District Court for the Eastern District of Washington under No. C-85-522-RJM. This put Saul Stone on further notice, as to the likelihood and foreseeability of such "Ponzi" schemes developing, when it did not diligently supervise the activities of its personnel and APs and when it did not comply with the rules and regulations of the CFTC, CME and NFA Manual.

95. The failure of Defendants, FCMs to properly and diligently train, manage, supervise and investigate the activities of their respective FCM EMPLOYEES, as well as Kohli, Chandran and the Sigma Entities, pursuant to 17 CFR Section 166.3, facilitated the occurrence of the activities complained herein.

96. On April 17, 1995 the CFTC filed the Sigma Civil Action against Kohli and Chandran alleging among other things fraud in connection with commodity futures and

options transactions, including the solicitation of funds from innocent third parties to be invested in pooled accounts in contravention of the CEA and CFTC regulations. In addition thereto, Kohli pleaded guilty to the criminal complaint filed in the Kohli Criminal Action alleging among other things commodities fraud. The General outline of the "Ponzi" scheme was disclosed in the Sigma Civil Action and Kohli Criminal Action. Furthermore, it was admitted that Kohli and Chandran were not registered with the CFTC nor members of the NFA.

97. Defendants, FCMs and FCM EMPLOYEES carried accounts, accepted orders and handled transactions in commodity futures contracts, for or on behalf of parties, not members of the NFA, who were also required to be registered with the CFTC. No disciplinary actions have been taken by the Defendant NFA against the Defendants FCMs and FCM EMPLOYEES. Further, no thorough, diligent and vigorous investigative action has been initiated by NFA concerning the management and conduct of the FCMs and FCM EMPLOYEES. The NFA receives compensation from the trading activities of the FCMs. The greater the number of trades, the greater the compensation to the NFA. The NFA has acted with reckless disregard in failing to discipline Saul Stone.

98. In the *Matter of Saul Stone & Company,* NFA Central Regional Business Conduct Committee, Case No. 86-6(c) (July 30, 1986), Defendant herein, Saul Stone was charged on May 23, 1986 with a violation of NFA Bylaw 1101 and violations of NFA Compliance Rule 2-7 for carrying the account of a person, Oxborrow, who was required to be registered as a CPO and was not so registered, nor registered as a member of the NFA, whom Saul Stone knew or should have known was required to be registered as a commodity pool operator and a member of the NFA. The facts of that case arise

out of the same facts as the Civil Action referred to in paragraph 79 of this Complaint, in the United Sates District for the Eastern District of Washington, Civil Action No. C-85-522-RJM.

99. Even after prior notices of alleged violations of the NFA Manual by Saul Stone, Defendant, NFA still took no disciplinary action for violations of the CEA, CFTC regulations and the NFA Manual against the Defendant, Saul Stone and the other Defendants herein, First Options, Smith Barney, Linnco, GNI, Dean Witter, ING, Merrill, Prudential, Rosenthal, E D & F and the FCM EMPLOYEES. The Defendant NFA has made no proper investigation of the activities of these Defendants.

100. The NFA is a part of a referral system with the states, CFTC, NASD and SEC. Through the referral system, these agencies refer matters to the NFA when such matters pertain to an NFA Member.

101. A Special Account is any account which has a reportable position as defined in Part 15 of the CFTC Regulations, which provides, in pertinent part, that a reportable position to the CFTC in options is a position in the put option or separately in the call option of a specified option expiration date that generally equals or exceeds fifty (50) options in futures contracts. FCMs must report to the CFTC and NFA any account in which the positions equal or exceed these limits. When identifying a Special Account a FCM should note the registration status of the person as a CTA or a securities investment advisor pursuant to 17 CFR § 17.01.

102. Defendant Linnco submitted a Report Form 102 (Identification of Special Accounts which is filed by a FCM) to the CFTC for the purpose of reporting Third Party Account Controllers, therein listing Sigma, Geron-

imo and Kohli. A number of the Form 102s on file with the CFTC indicate that an individual named "Mr. Chuck" Kohli was the Managing Director of Geronimo. Defendants FCMs failed to submit Form 102 on a daily and weekly basis as required by 17 CFR Section 17.01. The NFA knew or should have known of these Special Accounts, yet it took no action.

103. At various times beginning in 1989, Defendants FCMs authorized and permitted Defendants FCM EMPLOYEES to hold themselves out to Kohli, Chandran and the Sigma Entities as the respective agents of the FCMs and as such the FCMs accepted orders from Kohli, Chandran and the Sigma Entities for commodity futures transactions on the CME and CBOT and other commodity exchanges. Defendants, FCMs and FCM EMPLOYEES each received substantial commissions for such transactions. The amount of commissions earned, increased in direct proportion to the amount of trading done by Kohli and Chandran. There were approximately 10,000 trades per month. The number of trades were excessive under the circumstances, contrary to the best interests of the investors, and constituted "churning" of the account. Due to the high volume of commissions generated by FCM EMPLOYEES for their benefit and the benefit of the FCMs, the FCMs had little or no motivation to conduct a thorough and vigorous investigation of FCM EMPLOYEES and the activities of Kohli, Chandran and the Sigma Entities.

104. Had the FCMs diligently supervised the activities of FCM EMPLOYEES as required by NFA Compliance Rule 2-9, as well as Kohli, Chandran and the Sigma Entities, or made any reasonable investigation of the practices of Kohli, Chandran and the Sigma Entities, the FCMs would have discovered Kohli's, Chandran's

and the Sigma Entities' fraudulent investment scheme and the material misrepresentations and omissions.

105. Had the FCM EMPLOYEES diligently supervised the activities of Kohli, Chandran and the Sigma Entities, or made any reasonable investigation of the practices of Kohli, Chandran and the Sigma Entities, the FCMs would have discovered Kohli's, Chandran's and the Sigma Entities' fraudulent investment scheme and the material misrepresentations and omissions.

106. The NFA received substantial income due to the trades of Kohli, Chandran and the Sigma Entities. In general, the NFA receives substantial income due to the trading activity of Defendants FCMs and FCM EMPLOYEES on a "round-turn basis" and on a "per-trade basis" for a customer who is not a member of the exchange where the trade is made. Therefore, due to the high volume of income generated by Defendants, FCMs for the benefit of the NFA, the NFA had an ulterior motive with little or no motivation to conduct a thorough and vigorous disciplinary investigation of the FCMs.

107. Had the Defendant, NFA diligently and in some cases, i.e., Saul Stone, due to its past history, audited the activities of the FCMs with greater frequency, or made any reasonable investigation of the practices of the FCMs, the NFA would have discovered Kohli's, Chandran's and the Sigma Entities' fraudulent investment scheme and the material misrepresentations and omissions, as well as the violations of the CEA, CFTC regulations and the NFA Manual by the FCMs and the FCM EMPLOYEES.

108. In the case of Defendants, Delbridge and Stone, at all relevant times hereto, both were active Committee Members elected by the Members of the NFA to a Subcommittee of the NFA. In the case of Delbridge, he was

elected to the NFA Central Regional Business Conduct Committee, which receives reports for possible infraction(s) of NFA rules. Delbridge and Stone were principals, officers and director(s) of Saul Stone. Delbridge and Stone knew or should have known of the violations of the CEA and the NFA Manual by Saul Stone, as principals thereof, in relationship to Kohli, Chandran and the Sigma Entities.

109. Due to the high volume of commissions generated for the benefit of Defendant, Saul Stone, Delbridge and Stone had an ulterior motive with little or no motivation to conduct a thorough and vigorous disciplinary investigation of Defendant Saul Stone.

110. The failure of Delbridge and Stone to report the violations of the CEA and the NFA Manual to the NFA is a bad faith breach of their fiduciary duties and responsibilities as NFA Committee Members. Delbridge and Stone, on behalf of Saul Stone, willfully aided and abetted the Defendant, NFA from enforcing the NFA's Articles of Incorporation, Bylaws and Compliance Rules.

CLAIM I
(COMMODITY EXCHANGE ACT)

111. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 110, inclusive, as paragraph 111 of Claim 1.

112. By virtue of the activities described in this Complaint in connection with orders to make, and the making of, contracts of sale of commodities for future delivery, made or to be made, for or on behalf of any other person, Kohli, Chandran and the Sigma Entities have:

(a) Cheated defrauded, or attempted to cheat and defraud the Plaintiffs in violation of Section 4b(a)(i) of the Act, 7 U.S.C. § 6b(a)(i) (Supp. IV 1992); and,

(b) Willfully made or caused to be made to such persons a false report or statement thereof, or willfully entered or caused to be entered for such persons a false record thereof, in violation of Section(a)(ii) of the Act, 7 U.S.C. § 6b(a)(ii) (Supp. IV 1992).

113. By virtue of the activities described in this Complaint, Kohli, Chandran and the Sigma Entities by use of the mails and other means or instrumentalities of interstate commerce, directly or indirectly, employed devices, schemes, or artifices to defraud Plaintiffs and prospective third-party investors, and have engaged in transactions, practices or a course of business, that operate as a fraud or deceit, upon Plaintiffs and prospective third-party investors, in violation of Section 4 o(1) of the CEA, 7 U.S.C. § 6 o(1) (Supp. IV 1992).

114. Section 1a(4) of the CEA, 7 U.S.C. § 1a(4) (Supp. IV 1992), defines CPO as any person engaged in a business, that is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market.

115. Pursuant to Commission Regulations 33.2, 17 C.F.R. § 33.2 (1993), the provisions of Section 1a(4) (Supp. IV 1992), shall apply to commodity option trans-

actions that are subject to the requirements of Part 33 of the Regulations, 17 C.F.R. § 33.1, *et seq.*, (1993), as though such provisions included specific references to commodity option transactions.

116. By engaging in the activities referred to in the Complaint, Kohli and Chandran have attempted to act as a CPO, as that term is defined in Section 1a(4) of the CEA, 7 U.S.C. § 1a(5) (Supp. IV 1992).

117. With certain expectations not relevant hereto, pursuant to Section 4m(1) of the CEA, 7 U.S.C. § 6m(1) (Supp. IV 1992), it is unlawful for any CPO, without being registered under the CEA, to make use of the mails or any means or instrumentality of interstate commerce in connection with its business as a CPO.

118. By engaging in the activities referred to in this Complaint, Kohli and Chandran have attempted to act as a CTA, as the term is defined in 7 U.S.C. § 1a(5).

119. With certain exceptions not relevant hereto, pursuant to 7 U.S.C. § 6m(1), it is unlawful for any CTA, without being registered under the CEA, to make use of the mails or any means or instrumentality of interstate commerce in connection with its business as a CTA.

120. Throughout the relevant time period, Kohli, Chandran and the Sigma Entities were engaged in advising others as to the value or advisability of trading in commodities and managing their funds for a fee.

121. Pursuant to Sections 13(a) and 13(b) of the Act, 7 U.S.C. §§ 13 c(a) and 13c(b) (Supp. IV 1992), Kohli and Chandran are each liable for any violations of Section 4m(l) of the CEA, 7 U.S.C. § 6m(l) (Supp. IV 1992), in that they each willfully aided and abetted such violations and/or, directly or indirectly, controlled persons who have violated the CEA regulations and did not

act in good faith or knowingly induced, directly or indirectly, the acts, omissions or, failures constituting such violations.

122. The Commodity Act further provides, in pertinent part, that:

> It shall be unlawful for any person to be associated with a commodity pool operator as a partner, officer, employee, consultant, or agent (or any person occupying a similar status or performing similar functions), in any capacity that involves (i) the solicitation of funds, securities, or property for a participation in a commodity pool or (ii) the supervision of any person or persons so engaged, unless such person is registered with the Commission (CFTC) under this chapter. (7 U.S.C. § 6K(2))

and

> It shall be unlawful for any person to be associated with a commodity trading advisor as a partner, officer, employee consultant, or agent (or any person occupying a similar status or performing similar functions), in any capacity which involves (i) the solicitation of a client's or prospective client's discretionary account or (ii) the supervision of any person or persons so engaged, unless such person is registered with the Commission (CFTC) this chapter as a associated person or such commodity trading advisor. (7 U.S.C. § 6k(3)).

123. This Claim is brought pursuant to the CEA, 7 U.S.C. § 25(a) *et seq.*, the regulations established pursuant thereto by the CFTC and under the provisions of the NFA Manual. It is asserted against Defendants, FCMs, directly and through the acts of each of their FCM EMPLOYEES, as their respective agents or

employees, and FCM EMPLOYEES, in that they violated the CEA and the NFA Manual and willfully aided and abetted such violations.

124. Neither Kohli nor Chandran were registered with the CFTC as an AP of either a CPO or CTA, nor did they meet any exemption from such registration. Both Kohli and Chandran acted in violation of 7 U.S.C. § 6k for failing to register as APs of a CPO and CTA.

125. Neither Kohli nor Chandran were registered with the CFTC as a FCM or a CPO, nor did either meet an exemption from such registration. Therefore, neither Kohli nor Chandran could solicit, accept and/or pool customers' money.

126. Neither Kohli nor Chandran were registered with the CFTC as a CTA nor did either meet an exemption from such registration. Therefore, neither Kohli nor Chandran could direct the trading of customers' poiled money.

127. The Defendants, FCMs and FCM EMPLOYEES carried accounts, accepted orders and handled commodity futures contracts for Kohli, Chandran and the Sigma Entities, all non-Members of the NFA, exceeding their authority, as agents for the Plaintiffs.

128. Kohli, Chandran and the Sigma Entities had the authority as agents for the Plaintiffs to accept money and make direct deposits thereof with the FCMs, but were not, as unregistered persons, authorized to direct trades for investing of Plaintiffs money. As such, Kohli, Chandran and the Sigma Entities were a fiction under the CEA of which the FCMs and FCM EMPLOYEES were aware, or with required minimal due diligence would have discovered. As unregistered persons they did not exist under the CEA.

129. The trading of the Plaintiffs' money by the FCMs was unauthorized pursuant to 7 U.S.C. Section 6b.

130. During all relevant times herein, Defendants FCMs owned or held membership and were admitted to membership representation on a contract market or were given member's trading privileges thereon as a FCM within the meaning of § 2 of the CEA, as amended. Defendants, FCM EMPLOYEES were each first an AP with their respective FCMs within the meaning of the CEA and were each second an agent of their respective FCMs pursuant to common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

131. By virtue of such agency and AP relationship, the FCMs each had a duty, under Rule 932 of the CME, Rule 423.03 of the CBOT and 17 C.F.R. §§ 1.2 and 166.3 of the Regulations of the CFTC, to supervise each of their respective FCM EMPLOYEES.

132. In connection with the making of contracts of sale of commodities, in interstate commerce and purchase of an interest or participation in a commodity pool, on behalf of members of the Plaintiff Class, Defendants, FCMs, either directly or as willful aiders and abetters, cheated and defrauded Plaintiffs and willfully deceived or attempted to deceive Plaintiffs in regard to such purchases of contracts and participation in commodity pool(s) through deceptive practices, primarily including, but not necessarily limited to the facts set forth this Complaint and the churning alleged in this Complaint.

133. In addition to the facts and representations alleged above, during the Class Period Defendants, FCMs, directly or through each of their FCM EMPLOYEES, as their respective agents, knew or recklessly disregarded facts showing that:

(a) Kohli, Chandran and the Sigma Entities were engaged in soliciting accounts without being registered with the CFTC nor a Member of the NFA;

(b) Kohli, Chandran and the Sigma Entities were engaged in soliciting accounts and were making the representations alleged herein to the Plaintiff Class members;

(c) Kohli, Chandran and the Sigma Entities were guaranteeing the Plaintiffs against loss or agreeing to limit such loss, in violation of § 1.56 of the CFTC Regulations;

(d) Customer funds were being pooled in violation of § 4b of the CEA, 7 U.S.C. § 6b, (Regulation § 1.20 *et seq.*) without their knowledge or permission and were being used for speculation in the futures trading;

(e) Unusually large trading volumes and losses were being generated in the Sigma Entities accounts; and,

(f) Profits and losses were arbitrarily being allocated among such accounts at the discretion of Kohli and Chandran, in violation of CME Rules 536, 541, and 853.

134. In addition to the facts and representations alleged above, Defendants, FCMs aided and abetted the scheme to cheat, deceive and defraud the Plaintiff Class members by, *inter alia:*

(a) Authorizing and allowing their respective FCM EMPLOYEES to hold themselves out as their respective agents and to act as their respective

agents in soliciting investors like Kohli, Chandran and the Sigma Entities;

(b) Authorizing and allowing their respective FCM EMPLOYEES to engage in substantial and unusually large trades, both in number and volume, in violation of Rule 444 of the CME, through its offices and facilities and without requiring them, respectively, to disclose the true identity of the investors and nature of the accounts for which the trades were being made;

(c) Failing to diligently supervise the activities of their FCM EMPLOYEES as their respective agents and employees in soliciting accounts, obtaining Plaintiffs funds and using funds obtained in futures trading, in violation of Rule 932 of the CME, Rule 423.03 of the CBOT and 17 C.F.R. § 166.3 of the CFTC Regulations; and,

(d) Failing to properly and diligently investigate fraudulent and illegal conduct by their respective FCM EMPLOYEES in the conduct of their respective business with Kohli, Chandran and the Sigma Entities.

135. Defendants, FCMs' and FCM EMPLOYEES' actions were in violation of the CEA, as amended, specifically including, but not necessarily limited to 7 U.S.C. §§ 6b, 6k, 6o and § 25(a), the NFA Manual, specifically including but not limited to NFA ByLaw 1101 and NFA Compliance Rule 2-8(e). The violations of the registration provisions of the CEA committed by Kohli, Chandran and the Sigma Entities were willfully aided and abetted by the Defendants, FCMs and FCM EMPLOYEES. As a direct and proximate result of said

Defendants' violations of the CEA and NFA Manual, the members of the Plaintiff Class have suffered substantial damages to be proved with particularity at time of trial.

WHEREFORE, Plaintiffs demand judgment, jointly and severally against Defendants, FCMs and FCM EMPLOYEES, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(e) Pre-judgment interest.

(f) For such other and further relief as the Court deems just and proper.

CLAIM II
(BREACH OF CONTRACT)

136. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 135, inclusive, as paragraph 136 of Claim II.

137. This Claim is brought pursuant to New Jersey common law regarding contracts and is asserted against Defendants, FCMs, FCM EMPLOYEES and the NFA. The NFA establishes and enforces rules and standards for customer protection. The Sigma Entities are customers for whose express benefit and protection these agreements, rules and standards were adopted. The Plaintiffs are third party beneficiaries of the agreements between the NFA and its Members.

138. The FCMs and the FCM EMPLOYEES are Members of the NFA. As Members of the NFA, the aforesaid Defendants are bound by its Rules—its Rules are in the nature of agreements with all of its Members. The NFA has Compliance Rules, enforcement of which affect the integrity of the organization and its Members.

139. The NFA Rules in many instances are a memorialization of parts of the CEA. In particular, the requirement for persons to register pursuant to 7 U.S.C. Sections 6d., 6e., 6k. and 6n., and therefore, it is a violation to transact business if one is not registered or with one who is not registered.

140. The activities of CTAs and CPOs are affected with a national public interest as are all transactions in commodities involving the sale thereof for future delivery. 7 U.S.C. Sections 5 and 61.

141. Article III of the Articles of Incorporation of the NFA set forth in Section 1(a) one of the fundamental purposes of the NFA, as follows, "the adoption, admin-

istration and enforcement as to the following persons of requirements regarding fair practice and designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade and, in general, to protect the public interest.

"(i) Members that are registered with the Commission as Futures Commission Merchants, Commodity Pool Operators, Commodity Trading Advisors, Introducing Brokers or Leverage Transaction Merchants; and,

"(ii) associates (See Article XVIII)."

142. The general public, and therefore the Plaintiffs, are third party beneficiaries of the NFA Manual and the agreements between the NFA and its Members, including the Defendants, FCMs, FCM EMPLOYEES, Delbridge and Stone.

143. As a result of the Defendants', FCMs', FCM EMPLOYEES', Delbridge's and Stone's failure to comply with the NFA Manual, more particularly, without limitation, the CEA, NFA Bylaw 1101 and NFA Compliance Rule 2-8(e), they have breached their agreements with the NFA and as a result thereof, breached their agreements with the Plaintiffs.

144. Defendants', FCMs', FCM EMPLOYEES', Delbridge's and Stone's actions, in breach of their respective agreements with the NFA, and therefore the Plaintiffs as third party beneficiaries thereof, are in violation of the CEA, as amended, the NFA Manual, specifically including, but not limited to NFA Bylaw 1101 and NFA Compliance Rule 2-8(e). As a direct and proximate result of said Defendants' violations of the CEA and NFA Manual, the members of the Plaintiff Class have

suffered substantial damages to be proved with particularity at time of trial.

145. As a result of the Defendant's, NFA's failure to enforce the CEA, NFA Bylaws and Compliance Rules of the NFA Manual, more particularly, without limitation, NFA Bylaw 1101 and NFA Compliance Rule 2-8(e), the NFA has breached its agreement with the NFA Members and as a result thereof, breached its agreement with the Plaintiffs.

146. Defendant's, NFA's actions, in breach of its agreement with the NFA Members, and therefore the Plaintiffs as third party beneficiaries thereof, is in violation of the CEA, as amended, the NFA Manual, specifically including, but not limited to NFA Bylaw 1101 and NFA Compliance Rule 2-8(e). As a direct and proximate result of the NFA's violations of the CEA and NFA Manual, the members of the Plaintiff Class have suffered substantial damages to be proved with particularity at time of trial.

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against all Defendants, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) Punitive Damages.

(e) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(f) Pre-judgment interest.

(g) For such other and further relief as the Court deems just and proper.

CLAIM III
(BAD FAITH FAILURE TO ENFORCE NFA RULES)

147. Plaintiffs reallege and incorporate by this reference paragraphs I through 146, inclusive, as paragraph 147 of Claim III.

148. This Claim is brought pursuant to the CEA, 7 U.S.C. § 25(b) and the regulations established pursuant to the CFTC. It is asserted against the Defendant NFA, in that the NFA acted in bad faith in failing to enforce its own Bylaws and Rules, as set forth in the NFA Manual, pursuant to 7 U.S.C § 21(b)(8).

149. This Claim is brought pursuant to the CEA 7 U.S.C. § 25 and the regulations established pursuant to the CFTC, and is asserted against the Defendants, Delbridge and Stone, in that they knew or should have known of the violations of the CEA and the NFA Manual by Saul Stone in relationship to Kohli, Chandran and the Sigma Entities. The failure of Delbridge and Stone to report the violations of the CEA and the NFA Manual to the NFA is a bad faith breach of their fiduciary duties and responsibilities as NFA Committee Members. Delbridge and Stone, on behalf of Saul Stone, willfully

aided and abetted Defendant, NFA from enforcing the NFA's Articles of Incorporation, Bylaws and Compliance Rules.

150. Neither Kohli, Chandran, nor any of the Sigma Entities were registered with the CFTC as either a CPO or a CTA, nor did they satisfy the conditions necessary to meet any exemption from such required registration. As such, Kohli, Chandran and the Sigma Entities acted in violation of 7 U.S.C. § 6m in operating as unregistered CTAs and Kohli, Chandran and the Sigma Entities operated as unregistered CPOs and CTAs utilizing the mails and other means and instrumentalities of interstate commerce.

151. The Commodity Act further provides, in pertinent part, that:

> It shall be unlawful for any person to be associated with a commodity pool operator as a partner, officer, employee, consultant, or agent (or any person occupying a similar status or performing similar functions), in any capacity that involves (i) the solicitation of funds, securities, or property for a participation in a commodity pool or (ii) the supervision of any person or persons so engaged, unless such person is registered with the Commission (CFTC) under this chapter. (7 U.S.C. § 6K(2))

and

> It shall be unlawful for any person to be associated with a commodity trading advisor as a partner, officer, employee consultant, or agent (or any person occupying a similar status or performing similar functions), in any capacity which involves (i) the solicitation of a client's or prospective client's discretionary account or (ii) the supervision of any per-

son or persons so engaged, unless such person is registered with the Commission (CFTC) under this chapter as a associated person or such commodity trading advisor. (7 U.S.C. § 6k(3)).

152. The NFA Bylaw 1101 provides, in pertinent part, that:

> "No Member may carry an account, accept an order or handle a transaction in commodity futures contracts for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission (CFTC) as an FCM, IB (Introducing Broker), CPO, CTA or LTM (Leverage Transaction Merchants), and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or any other person." (Chapter 11)

153. Both Kohli and Chandran were the only officers and directors of the Sigma Entities and as such were APs of the Sigma Entities. Accordingly, both ere required to register with the CFTC as Associated Persons.

154. Neither Kohli nor Chandran were registered with the CFTC as an AP of either a CPO or CTA, nor did they meet any exemption from such registration. Both Kohli and Chandran acted in violation of 7 U.S.C. § 6(k) for failing to register as APs of a CPO and CTA.

155. Neither Kohli nor Chandran were registered with the CFTC as either a CPO or CTA, nor did they meet an exemption from such registration.

156. The Commodity Act further provides, in pertinent part, that:

> It shall be unlawful for any person to be associated with a futures commission merchant (FCM) as a partner, officer or employee (or any person occupying a similar status or performing similar functions), in any capacity that involves (i) the solicitation or acceptance of customer's orders (other than a clerical capacity) or (ii) the supervision of any person or persons so engaged unless such person is registered with the Commission (CFTC) under this chapter. (7 U.S.C. § 6k(l)).

157. The Defendants, FCMs and FCM EMPLOYEES carried accounts, accepted orders and handled commodity futures contracts for the Plaintiffs through Kohli, Chandran and the Sigma Entities, all non-Members of the NFA.

158. During all relevant times herein, Defendants, Delbridge and Stone were employed by Saul Stone, a FCM and a named Defendant herein. As such, each was an agent of Saul Stone pursuant to common law and within the meaning of 7 U.S.C. § 4 and 17 C.F.R. § 1.2.

159. During the course of their respective positions as employees, officers and director(s) of Saul Stone, Delbridge and Stone knew, or should have known, of the actions of Kohli, Chandran and the Sigma Entities that violated the registration provisions of the CEA.

160. During all relevant times herein, Defendants, Delbridge and Stone were NFA Committee Members. As such, each was an agent of the NFA.

161. The NFA knew, or should have known, of the actions of Kohli, Chandran and the Sigma Entities that violated the registration provisions of the CEA as well as the association between the FCMs and the FCM EMPLOYEES with Kohli, Chandran and the Sigma

Entities. The NFA has taken no disciplinary action against the FCMs and FCM EMPLOYEES for violations of the CEA, CFTC Regulations and the NFA Manual.

162. The Defendant, NFA has acted in bad faith in failing to enforce its own Rules, as set forth in the NFA Manual, pursuant to 7 U.S.C. § 21(b)(8) which provides, in pertinent part, that:

> ". . . its [NFA] Members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violations of its rules."

The NFA failed to prevent fraudulent and manipulative practices among its Members to protect customers and option customers and customer funds and to promote fair dealing with the public pursuant to 17 CFR § 170.5 as well as § 17(b) of the CEA.

163. The failure of Delbridge and Stone to report the violations by Kohli, Chandran, the Sigma Entities, Saul Stone and John Doe of the CEA and the NFA Manual to the NFA was a breach of their fiduciary duties and responsibilities as NFA Committee Members and was in bad faith. Delbridge and Stone, on behalf of Saul Stone, willfully aided and abetted Defendant, NFA from enforcing the NFA's Articles of Incorporation, Bylaws and Compliance Rules.

164. The bad faith actions of the Defendants, Delbridge, Stone and NFA were in violation of the CEA, as amended, specifically including, but not necessarily limited to 7 U.S.C. §§ 6b and 6k and the NFA Manual, specifically including, but not limited to NFA Bylaw 1101 and NFA Compliance Rule 2-8(e). Such bad faith

actions by Delbridge and Stone on behalf of the Defendant, Saul Stone, willfully aided and abetted the Defendant, NFA, to fail to enforce its Compliance Rules and NFA Bylaw 1101, resulting in violation of the CEA, 7 U.S.C §§ 6b, 6k, 21 and 25, thereby causing the members of the Plaintiff Class to suffer substantial damages to be proved with particularity at time of trial.

165. By reason of the conspiracy among the Defendants, Saul Stone, Delbridge, Stone and the NFA, the NFA failed to enforce, and, instead, violated its Articles of Incorporation, Bylaws and Compliance Rules and, likewise, failed to perform the duties imposed on it by, and thereby violated the provisions of the 7 U.S.C. §§ 25(b)(2) and 21 (b)(8).

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against Defendants, Saul Stone, Delbridge, Stone and NFA, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) Pre-judgment interest.

(e) For such other and further relief as the Court deems just and proper.

CLAIM IV
(NEW JERSEY UNIFORM SECURITIES LAW)

166. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 165, inclusive, as paragraph 166 of Claim IV.

167. This claim is brought pursuant to the New Jersey Uniform Securities Law, N.J.S.A. 49:3-47 *et al.*, and is asserted against Defendants, FCMs and FCM EMPLOYEES, named herein as primary offenders or, in the alternative, as secondary offenders. Liability of Defendants, FCMs is premised on their direct activities, and in the alternative, on the activities of their FCM EMPLOYEES, as their respective agents or employees.

168. The members of the Plaintiff Class invested funds through Kohli, Chandran and the Sigma Entities, for the purpose of gaining profit solely by the efforts of Kohli and Chandran, through a common enterprise, including, *inter alia*, the sharing of profits as alleged previously in this Complaint. All commodity futures contract purchases and other investment decisions for investment of Plaintiffs' funds were made by Kohli and Chandran. Said investments constituted investment contract securities.

169. The agreement forms, attached hereto as Exhibit "C" and incorporated herein by this reference, prepared by Kohli, Chandran and the Sigma Entities and executed and delivered to members to the Plaintiff Class, constituted certificates of interest or participation in a profit-sharing agreement and/or evidence of indebtedness and

were securities within the meaning of New Jersey Uniform Securities Law, N.J.S.A. 49:3-49(m).

170. During the Class Period, Kohli and Chandran, in the offer and sale of certain securities, namely the above referenced certificates of interest and participation in profit-sharing agreements, evidence of indebtedness and investment contracts issued by them in the names of the Sigma Entities, which pertained to participation interests in one or more commodity futures pooled accounts operated and managed, or to be operated and managed by them, did knowingly and willfully, directly and indirectly, employ a devise, scheme an artifice to defraud, obtain money and property from Plaintiff Class members by means of untrue statements of material facts and omissions to state material facts necessary, in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in transactions, practices and a course of business which would and did operate as a fraud and deceit upon the Plaintiff Class members purchasing said securities, all as more particularly described in this Claim and the paragraphs incorporated herein.

171. The facts and allegations set forth in this Complaint more specifically describe said devices, schemes and artifices to defraud, said untrue statements and omitted facts, and said transactions, practices and course of business of Kohli, Chandran, the Sigma Entities, the FCMs and the FCM EMPLOYEES, which operated as a fraud and deceit upon the Plaintiff Class members.

172. Defendants, FCMs and FCM EMPLOYEES knew, or in the exercise of reasonable care, should have known that Kohli, Chandran and the Sigma Entities were offering and/or selling securities through the false and deceitful means, alleged in this Complaint and

Defendants, FCMs and FCM EMPLOYEES intentionally, with reckless disregard or conscious avoidance of the truth, or negligently consented to, participated in, aided, abetted and conspired with Kohli, Chandran and the Sigma Entities in said illegal securities sales to the Plaintiff Class members.

173. Defendants, FCMs, directly and primarily participated in, aided and abetted and conspired in the illegal practices of Kohli, Chandran and the Sigma Entities alleged herein by, *inter alia:*

(a) Accepting orders and purchasing commodity futures contracts with funds the FCMs knew or should have known were procured illegally from Plaintiff Class members;

(b) Paying commissions on said trades to Defendants, FCM EMPLOYEES;

(c) Retaining commissions on said trades;

(d) Failing to investigate, directly or through their respective agents, the investment practices of Kohli, Chandran and the Sigma Entities;

(e) Knew, or should have known the source of funds for Kohli's, Chandran's and the Sigma Entities' Investments were those of the Plaintiff Class members;

(f) Knew, or should have known, that Kohli and Chandran were not licensed CPOs;

(g) Failing to properly and diligently supervise the activities of FCM EMPLOYEES at their respective offices;

(h) Failing to inform the Plaintiff Class members, of the false nature of the representations, and

material omissions alleged in this Complaint; and,

(i) Receiving and disbursing Plaintiffs funds, delivered to it by Kohli, Chandran and the Sigma Entities, through their respective FCM EMPLOYEES without regard for the reasonable expectations of the investors involved, or the methods used for procurement of said funds.

174. Defendants, FCM EMPLOYEES, directly and primarily participated in, aided and abetted and conspired in the illegal practices of Kohli and Chandran alleged herein by, *inter alia*:

(a) Failing to inform the Plaintiff Class members of the false nature of the representations and material omissions alleged herein;

(b) Placing trades and accepting commissions from Defendants, FCMs for said trades, and upon information and belief, accepting other compensation from Kohli, Chandran and the Sigma Entities for their respective services, when they knew Kohli, Chandran and the Sigma Entities were trading with money provided by Plaintiff Class members and yet were not licensed CPOs and that said money was obtained by fraud and deceit; and,

(c) Receiving and disbursing Plaintiffs' funds as delivered to them, respectively, by Kohli, Chandran and the Sigma Entities without regard for the reasonable expectations of the Plaintiffs or the methods used for procurement of said funds.

175. At the time that all of Plaintiff Class members' funds were delivered to Kohli, Chandran and the Sigma Entities for purchase of said securities, the Plaintiff Class Members were ignorant of the falsity of the said representations and/or omissions of material facts, necessary to be known by the Plaintiffs, to enable them to make informed decisions regarding said securities.

176. The Plaintiff Class members justifiably relied on the alleged misrepresentations and omissions and were thereby induced to invest in said securities.

177. The Plaintiff Class members would not have invested in said securities, if they had known the truth, concerning the material facts or omissions referred to above.

178. By reason of the foregoing and as a proximate result thereof, the Plaintiff Class members have been damaged in an amount to be proved at trial and Defendants, FCMs and FCM EMPLOYEES are liable for said damages as primary offenders, plus interest at twelve (12%) percent per annum, pursuant to the New Jersey Uniform Securities Law, N.J. S.A. 49:3-47, *et seq.*, and N.J.S.A. 49:3-71.

179. In the alternative, Defendants, FCMs and FCM EMPLOYEES are secondarily liable to Plaintiffs under the New Jersey Uniform Securities Law N.J.S.A. 49:3-47, *et seq.*, and N.J.S.A. 49:3-71, by virtue of their positions as controlling persons, who were able to directly and/or indirectly control Kohli, Chandran and the Sigma Entities, by eliminating the means for Kohli, Chandran and the Sigma Entities to invest Plaintiffs' funds in commodity futures contracts and by exercise of control over the accounts of the Sigma Entities. Specifically, *inter alia*, Kohli and Chandran had full discretion in the trading of all contracts purchased through said accounts.

Defendants, FCMs and FCM EMPLOYEES had contractual, statutory and regulatory rights and obligations of control over Kohli, Chandran and the Sigma Entities and said accounts. Defendants, FCMs and FCM EMPLOYEES provided substantial assistance to Kohli, Chandran and the Sigma Entities, as alleged in this Complaint, and failed to exercise their control and investigatory powers over the investment practices of Kohli, Chandran and the Sigma Entities, in a prudent manner, and thereby aided in the perpetration of the illegal acts alleged herein. Defendants, FCMs and FCM EMPLOYEES had a special or fiduciary duty to Plaintiffs under statute, regulations and common law. All damages suffered by Plaintiffs as alleged herein, are directly and proximately due to said activities of said Defendants as controlling persons.

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against Defendants FCMS and FCM EMPLOYEES, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages and at no less than twelve (12%) percent per annum per N.J.S.A. 49:3-71.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) Punitive Damages.

(e) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(f) Pre-judgment interest.

(g) For such other and further relief as the Court deems just and proper.

CLAIM V
(SECURITIES ACT OF 1933)

Omitted.

CLAIM VI
(SECURITIES EXCHANGE ACT OF 1934)

Omitted.

CLAIM VII
(BREACH OF FIDUCIARY DUTIES)

180. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 179, inclusive, as paragraph 180 of Claim VII.

181. This claim is brought pursuant to common law and is asserted against Defendants, FCMs, FCM EMPLOYEES, Delbridge, Stone and the NFA named herein. Liability of Defendants is premised on their direct activities and, in the alternative, in the case of the

FCMs on the activities of their respective FCM EMPLOYEES.

182. Defendants, FCMs, FCM EMPLOYEES, Delbridge, Stone and the NFA knew, or should have known, in the exercise of reasonable care that money invested by Kohli and Chandran were the property of the Plaintiff Class members. Said Defendants, were fiduciaries or quasi-fiduciaries, with respect to the Plaintiff Class members in connection with futures contracts and the funds deposited with them by Plaintiff Class members through Kohli and Chandran and were required to exercise reasonable and prudent discretion in connection with such transaction in the best interest of Plaintiffs.

183. Defendants, Delbridge, Stone and the NFA knew or should have known of their obligations under the CEA pursuant to 7 U.S.C. §§ 21 and 25 to enforce the Rules of the NFA, in particular, Bylaw 1101.

184. Defendants, FCMs and FCM EMPLOYEES violated their fiduciary duties to Plaintiff Class members by acts and omissions including, *inter alia*, the following:

(a) Defendants, FCMs failed to provide a reasonable amount of training to and diligent supervision of their agents, FCM EMPLOYEES;

(b) Defendants failed to inform the Plaintiff Class members of the risks associated with speculation in the commodity futures market;

(c) Defendants accepted money from Kohli and Chandran for investment when they knew, or should have known, or had reason to believe that the money was obtained from the Plaintiffs Class and that Kohli and Chandran were not CPOs; and,

(d) Defendants, FCMs and FCM EMPLOYEES through non-disclosure of facts known to them, or which they had reason to know, deceived the Plaintiff Class members in connection with risks involved in speculating in commodities futures accounts, the profits generated in Plaintiffs' accounts, documentation and paperwork generated in connection with Plaintiffs' accounts, the placement of specific orders in Plaintiffs' accounts, and the commissions gathered from said accounts.

185. Defendants, FCM EMPLOYEES directly and primarily participated in, aided and abetted and conspired in the illegal practices of Kohli and Chandran alleged herein by, *inter alia*:

(a) Failing to inform the Plaintiff Class members of the false nature of the representations and material omissions alleged herein;

(b) Placing trades and accepting commissions from the FCMs for said trades, upon information and belief and accepting other compensation from Kohli and Chandran for their respective services when they knew Kohli and Chandran, were trading with money provided by Plaintiff Class members and yet were not licensed CPOs and that said money was obtained by fraud and deceit; and,

(c) Receiving and disbursing Plaintiffs funds delivered to them, respectively, by Kohli and Chandran without regard for the reasonable expectations of the Plaintiffs or the methods used for procurement of said funds.

186. Defendants, Delbridge, Stone and NFA, directly and primarily participated in, aided and abetted and conspired in the illegal practices of Kohli, Chandran and the Sigma Entities, alleged herein by, *inter alia*:

(a) Breach of their fiduciary duties by Delbridge and Stone for failure to fulfill their duties and obligations as NFA Committee Members;

(b) Breach of its fiduciary duties by NFA in failing to enforce its Bylaws and Compliance Rules for the good of the public interest;

(c) The bad faith actions of Delbridge, Stone and the NFA in failing to enforce the CEA, as amended, and the NFA Manual;

(d) The bad faith actions of Delbridge, Stone and the NFA in failing to diligently supervise, frequently audit, investigate and discipline the activities of its Members, FCMs and FCM EMPLOYEES, to insure that they were doing business with Members of the NFA and that they operated in compliance with the CEA, CFTC regulations and the NFA Manual; and,

(e) The bad faith actions of Defendants, Delbridge, Stone and the NFA in failing to diligently supervise, investigate and discipline the activities of Kohli, Chandran and the Sigma Entities to insure that they operated in compliance with the CEA, CFTC regulations and the NFA Manual.

187. By reason of said breach of fiduciary duties by Defendants, FCMs, FCM EMPLOYEES, Delbridge, Stone and the NFA, the Plaintiff Class members have

suffered substantial damages the exact amount to be proved at time of trial.

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against the Defendants, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) Punitive Damages.

(e) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(f) Pre-judgment interest.

(g) For such other and further relief as the Court deems just and proper.

CLAIM VIII
(NEGLIGENCE)

188. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 187, inclusive, as paragraph 188 of Claim VIII.

189. This claim is brought pursuant to common law and is asserted against Defendants, FCMs and FCM EMPLOYEES named herein. Liability of Defendants, FCMs is premised on their direct activities and, in the alternative, on the activities of their respective FCM EMPLOYEES as their agents or employees.

190. Defendants, FCMs and FCM EMPLOYEES failed to exercise reasonable care, and were negligent and careless, by numerous acts and omissions alleged in this Complaint, including, but not necessarily limited to the following:

(a) Defendants, FCMs and FCM EMPLOYEES were negligent in failing to conduct more thorough investigations, of the source of funds, invested by Kohli and Chandran, doing business under the names of the Sigma Entities;

(b) Upon information and belief, Defendants, FCMs and FCM EMPLOYEES were negligent in assisting and encouraging Kohli and Chandran in soliciting investors for commodity futures trades under the business names of the Sigma Entities;

(c) Defendants, FCMs were negligent in failing to adequately train their respective agents, FCM EMPLOYEES, with regard to the laws and regulations governing commodity futures trading and the NFA Ethics Rules; and,

(d) Defendants, FCMs were negligent in failing to adequately and diligently supervise the actions of their respective agents, the FCM EMPLOYEES and in failing to diligently supervise the activities at their respective offices and solici-

tation of accounts traded through their respective offices.

191. As a direct and proximate result of the negligent acts of Defendants, FCMs and FCM EMPLOYEES the Plaintiff Class members have suffered substantial damages, the exact amount to be proved at time of trial.

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against Defendants, FCMs and FCM EMPLOYEES, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(e) Pre-judgment interest.

(f) For such other and further relief as the Court deems just and proper.

CLAIM IX
(RICO, 18 U.S.C. § 1962(c))

192. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 191, inclusive, as paragraph 192 of Claim IX.

193. The ("person(s)") as defined in 18 U.S.C. § 1961(3) are Kohli and Chandran.

194. The ("enterprise(s)") as defined as 18 U.S.C. § 1961(4), which was engaged in and the activities of which affect interstate commerce are the Sigma Entities.

195. The activities of Kohli, Chandran and the Sigma Entities were conducted through a pattern of racketeering activities, which included numerous acts of fraud over a period of approximately five (5) plus years against at least four hundred (400) investors through the use of United States Mail, including the mailing of accounts statements and activity reports, and interstate wires, including telephone calls from Kohli and Chandran, in furtherance of the Kohli and Chandran scheme to defraud by means of the Sigma Entities, in violation of 18 U.S.C. § 1341 and 18 U.S.C. § 1343, including, but not limited to:

(a) The fraudulent sale of Plaintiffs' futures contracts, commodity options, other commodities, futures contracts and commodity options including options and currencies not traded on a national exchange;

(b) The fraudulent solicitation by Kohli and Chandran of commodity customers;

(c) Materially misrepresenting the success of the Sigma Entities' past and current performance to

investors and potential investors as an inducement to their continued investing;

(d) Materially overstating the amount of Plaintiffs' funds under management;

(e) Informing certain investors that their investments were fully insured by Lloyds of London, when in fact they were not; and,

(f) Engaging in a fraudulent "Ponzi" scheme.

196. During the course of the period of time during which the Defendants, FCMs and FCM EMPLOYEES made a practice of opening Special Accounts for and over which Kohli and Chandran, under the business names of the Sigma Entities, exercised discretion as Third Party Account Controllers, the FCMs and FCM EMPLOYEES acquired knowledge, that:

(a) Kohli, Chandran and the Sigma Entities were not registered with the CFTC nor Members of the NFA;

(b) Kohli, Chandran and the Sigma Entities did not provide a Written Statement to the Plaintiffs, describing among other things their exemption, pursuant to 17 CFR § 4.13;

(c) Kohli, Chandran and the Sigma Entities did not provide a Written Statement to the FCMs and FCM EMPLOYEES, describing among other things their exemption, pursuant to 17 CFR § 4.13;

(d) Kohli, Chandran and the Sigma Entities did not provide a Disclosure Document to the Plaintiffs describing among other things their exemption,

pursuant to 17 CFR § 4.21 and NFA Compliance Rule 2.13; and,

(e) Kohli, Chandran and the Sigma Entities were consistently losing the Plaintiffs' money through trading activities with the FCMs and FCM EMPLOYEES.

197. With this knowledge, the Defendants, FCMs and FCM EMPLOYEES participated directly or indirectly in the conduct of such enterprises' affairs through a pattern of racketeering activity in violation of 18 U.S.C. § 1962(c) by engaging in numerous acts between January 1, 1989 and April 12, 1995 which were related to each other so as to effect the common scheme to secure and maintain Plaintiff Class members' investment in the enterprise and to lull them into a false sense of security with respect to these investments, including:

(a) Failing to refuse to carry accounts, accept and handle transactions and commodity futures contracts on behalf of Kohli, Chandran and the Sigma Entities;

(b) Failing to demand that Kohli, Chandran and the Sigma Entities deliver the Written Statement, describing among other things, the exemption of Kohli, Chandran and the Sigma Entities to register with the CFTC;

(c) Failing to obtain from Kohli, Chandran and the Sigma Entities receipts signed by the Plaintiffs for the required Disclosure Agreement pursuant to 17 CFR § 4.24; and,

(d) Receiving commission income from the trading of commodities and commodity futures con-

tracts—derived directly from the patterns of racketeering activity.

198. The RICO Act provides in pertinent part, that:

> "It shall be unlawful for any person to conspire to violate any of the provisions of the . . . ." 18 U.S.C. §§ 1962(c),(d).

199. Defendants, FCMs and FCM EMPLOYEES, participated in the conduct of the enterprises' affairs through the aforementioned pattern of racketeering activity in violation of 18 U.S.C. § 1962(c).

200. With knowledge that Kohli, Chandran and the Sigma Entities were engaged in racketeering activities, the FCMs and the FCM EMPLOYEES willfully aided and abetted Kohli, Chandran and the Sigma Entities in their conduct of such enterprises affairs through a pattern of racketeering in violation of 18 U.S.C. § 1962(c).

201. As a direct and proximate result of the acts of Defendants, FCMs and FCM EMPLOYEES, in violation of 18 U.S.C. § 1962, the Plaintiff Class members have suffered substantial damages, the exact amount to be proved at the time of trial.

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against Defendants, FCMs and FCM EMPLOYEES, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an

amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss clue to unexpected adverse tax consequences.

(d) For tripling of all judgments under RICO, for each Plaintiff Class member, together with reasonable attorney's fees and costs of suit.

(e) Punitive Damages.

(f) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(g) Pre-judgment interest.

(h) For such other and further relief as the Court deems just and proper.

CLAIM X
(FRAUD AND CIVIL CONSPIRACY)

202. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 201, inclusive, as paragraph 202 of Claim X.

203. This Claim is brought pursuant to New Jersey common law and is asserted against Defendants, FCMs and FCM EMPLOYEES named herein. Liability of Defendants, FCMs is premised on their direct activities and, in the alternative, on the activities of their respective FCM EMPLOYEES.

204. Sometime between approximately January 1, 1989 and April 12, 1995 Kohli, Chandran and the Sigma Entities, none of whom were registered with CFTC nor the NFA, approached the Defendants FCMs to place all orders to purchase or sell futures contracts through said Defendants, each of whom were then and continue to be registered as a FCM pursuant to the CEA 7 U.S.C. § 6f and a member of the NFA. All orders to purchase or sell futures contracts with the funds solicited by Kohli, Chandran and the Sigma Entities would be placed directly through the Defendants FCMs or in the alternative, indirectly through FCM EMPLOYEES of the respective FCMs.

205. At all times pertinent hereto, Defendants FCMs opened Special Accounts for investment in commodities, for future delivery and/or options on commodities for Kohli and Chandran, through business names of Sigma, Inc., Geronimo, Inc. a/k/a Geronimo Group, Vol Partners, L. P. and Savid Group, as Third-Party Account Controllers without CFTC registration and NFA membership.

206. The Defendants, FCMs and FCM EMPLOYEES failed to investigate and know their customer. Upon information and belief the aforesaid Defendants failed to perform minimum due diligence by not contacting the CFTC and the NFA to gather information regarding Kohli, Chandran and the Sigma Entities pursuant to NFA Compliance Rule 2-8(e).

207. Neither Kohli nor Chandran were registered with the CFTC as either a CPO or CTA, nor did either meet an exemption from such registration.

208. The Defendants, FCMs and FCM EMPLOYEES carried accounts, accepted orders and handled com-

modity futures contracts for Kohli, Chandran and the Sigma Entities, all non-Members of the NFA.

209. At least as early as February, 1991, Saul Stone and later all FCMs and FCM EMPLOYEES knew in fact that Kohli, Chandran and the Sigma Entities were falsely representing to Plaintiffs and potential investors that they were operating in a lawful manner, held all licenses and registrations necessary to conduct their business, and operated under standards established by the appropriate state and Federal regulatory agencies with the intention that Plaintiffs should rely on these representations, and that Plaintiffs were relying upon these representations to their detriment.

210. As early as February, 1991, Saul Stone and later all FCMs and FCM EMPLOYEES knew in fact that Kohli, Chandran and the Sigma Entities did not provide a Written Statement to the Plaintiffs, describing among other things their exemption, pursuant to 17 CFR § 4.13.

211. At least as early as March, 1991, FCMs, in particular Saul Stone, and FCM EMPLOYEES knew that Kohli, Chandran and the Sigma Entities were becoming more and more deeply indebted to the Plaintiffs as a result of their misuse of the funds entrusted to them for investment purposes.

212. The FCMs and the FCM EMPLOYEES breached their duties by aiding and abetting Kohli, Chandran and the Sigma Entities in these frauds, conspiring with Kohli, Chandran and the Sigma Entities to commit these frauds, or acting in concert with Kohli, Chandran and the Sigma Entities to commit these frauds in concealing the true nature of their activities from Plaintiffs and potential investors by, *inter alia*:

(a) That Kohli, Chandran and the Sigma Entities were not registered and/or licensed CPO or in any other respect licensed to trade commodity futures contracts third parties, although they were required to be so licensed, if engaged in trading commodity futures for the Plaintiffs;

(b) That Kohli, Chandran and the Sigma Entities were not members of the NFA in any capacity;

(c) That Kohli, Chandran and the Sigma Entities were not registered and/or licensed under either state or Federal laws or regulations as a securities dealer, broker or other person permitted to sell securities to third parties;

(d) That the securities solicited and sold to Plaintiff Class members were not registered as securities under either state or Federal laws or regulations;

(e) That Defendants, FCMs and FCM EMPLOYEES earned commissions on every commodity futures contract trade made through FCMs;

(f) That Defendants, FCMs had not followed the rules and regulations of the CFTC and the NFA Manual concerning disclosure of information as required to be made to pool participants;

(g) That some of Plaintiff investors' funds were going to repay Defendants, FCMs for debit balances in the accounts;

(h) That Kohli and Chandran had very little, or no knowledge, about commodity futures contract trading and very little or no experience as an investor in commodity futures contracts;

(i) That Kohli and Chandran were not keeping or maintaining accurate and complete records of the handling of all sums received from members of the Plaintiff Class and/or funds invested in commodity futures contracts;

(j) In investing and managing the Plaintiffs' funds, Kohli, Chandran and the Sigma Entities had not followed the rules and regulations of the CFTC and the NFA Manual concerning the operations of such pools, the disclosures required to be made to pool participants, the records that must be made and kept by pool operators, and the availability of such records to pool participants;

(k) Kohli, Chandran and the Sigma Entities were becoming more and more deeply indebted to the Plaintiffs as a result of their misuse of the funds entrusted to them for investment purposes; and,

(l) Kohli, Chandran and the Sigma Entities had never earned any annual net income for the Plaintiffs on a consolidated basis through their investment of funds obtained from them.

213. Kohli, Chandran and the Sigma Entities defrauded Plaintiffs by intentionally creating the false public perception that the unregistered pool was large, profitable and legitimate, and by failing to disclose material facts to investors.

214. Plaintiffs reasonably relied on the above-described false appearance in making their investment decisions.

215. The FCMs and FCM EMPLOYEES accepted the fruits (*i.e.*, commissions on the purchase and sale of commodity contracts) of the fraud. The FCMs and the

FCM EMPLOYEES knew or should have known that those funds had been obtained by fraud. Therefore, the FCMs and FCM EMPLOYEES are liable for the fraud as through they had directly participated in the fraudulent sales of the pool interests.

216. Defendants, FCMs directly and/or through their respective agents, the FCM EMPLOYEES, conspired in combination with Kohli, Chandran and the Sigma Entities to commit criminal or unlawful acts and/or to commit lawful acts for criminal or unlawful purposes described herein, specifically including, but not necessarily limited to conspiring to obtain funds, from the Plaintiff Class members, by misrepresentation and/or fraud and conspiracy to cover up the true nature of Kohli and Chandran's "Ponzi" scheme.

217. As a direct and proximate result of Defendants', FCMs' and FCM EMPLOYEES' actions in aiding and abetting Kohli, Chandran and the Sigma Entities in these frauds and conspiring to cover up the true nature of Kohli's, Chandran's and the Sigma Entities' "Ponzi" scheme, or acting in concert with Kohli, Chandran and the Sigma Entities, the Plaintiff Class members have suffered substantial damages, the exact amount to be proved at time of trial.

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against the Defendants, FCMs and FCM EMPLOYEES, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an

amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) Punitive Damages.

(e) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(f) Pre-judgment interest.

(g) For such other and further relief as the Court deems just and proper.

CLAIM XI
(CONSUMER PROTECTION)

218. Plaintiffs reallege and incorporate by this reference paragraphs 1 through 217, inclusive, as paragraph 218 of Claim XI.

219. This Claim is brought pursuant to the New Jersey Consumer Fraud Act, N.J.S.A 56:8-1, *et seq.* and is asserted against the Defendants, FCMs and FCM EMPLOYEES.

220. The Defendants, FCMs and FCM EMPLOYEES, have violated the New Jersey Consumer Fraud Act, N.J.S.A. 56:8-1 *et seq.*, by allowing Kohli, Chandran and the Sigma Entities to trade commodities, futures contracts, commodity options and contracts for sale of commodities for future delivery, on behalf of non-Mem-

bers of the NFA that are required to be registered with the CFTC, thereby causing the acts of Kohli, Chandran and the Sigma Entities to appear to be legal. As such, the illegal actions of the FCMs and the FCM EMPLOYEES were a material inducement to the Plaintiffs to turn over their funds to Kohli, Chandran and the Sigma Entities and, in fact, such illegal actions worked to deceive the Plaintiffs.

221. Said Defendants' acts alleged in this Complaint constitute unfair or deceptive trade practices and are in violation of the New Jersey Consumer Fraud Act, N.J.S.A 56:8-1, *et seq.*, in that they engaged in unfair and deceptive acts as detailed above, including among other things, the knowing concealment and suppression of a material fact, in that Kohli, Chandran and the Sigma Entities were not registered with the CFTC as an AP, a CPO or a CTA nor a member of the NFA, in connection with the sale of merchandise—commodities, futures contracts, commodity options and contracts for sale of commodities for future delivery, in violation of N.J.S.A. 56:8-2. Said acts by said Defendants are in violation of Federal and state statutes, enacted in the public interest and therefore constitute a *per se* violation of the New Jersey Consumer Fraud Act.

222. The New Jersey Consumer Fraud Act provides in pertinent part, that:

> "The term 'sale' shall include any sale, . . . , offer for sale, . . . , attempt directly or indirectly to sell . . . ." (N.J.S.A. 56:8-1(e)).

223. The Plaintiff Class members reasonably relied upon the unfair and deceptive acts of the Defendants, FCMs and FCM EMPLOYEES, were deceived and induced to deliver and pay money to Kohli, Chandran

and the Sigma Entities and thereby suffered substantial damages to their property, the exact amount to be proved at time of trial.

WHEREFORE, Plaintiffs demand judgment, jointly and severally, against Defendants, FCMs and FCM EMPLOYEES, as follows:

(a) For an award of compensatory damages equal to the amount of loss sustained by the Plaintiff Class members and commissions and fees paid to Defendants by the Plaintiff Class members as a result of Defendants' violation of law (in an amount which will be proved with more particularity at time of trial).

(b) For an award of damages to compensate the Plaintiff Class members for the loss of alternative investment opportunities as part of compensatory damages.

(c) For an award of damages to compensate the Plaintiff Class members for the loss due to unexpected adverse tax consequences.

(d) For tripling of all judgments under New Jersey Consumer Fraud Act, N.J.S.A. 56:8-19, for each Plaintiff Class member, together with reasonable attorney's fees and costs of suit.

(e) Punitive Damages.

(f) For Plaintiff Class members' attorney's fees, costs and disbursements incurred herein.

(g) Pre-judgment interest.

(h) For such other and further relief as the Court deems just and proper.

JURY DEMAND

THE PLAINTIFFS DEMAND A TRIAL BY JURY ON ALL ISSUES SO TRIABLE.

By Their Attorney

By: EDWARD M. BERNSTEIN
Edward M. Bernstein (EB 0774)
Attorney At Law
3371 Brunswick Pike
Suite 214
Lawrenceville, New Jersey
(609) 987-8300
Attorney for Plaintiffs

Dated: November 23, 1997

CERTIFICATION OF RICHARD NICHOLAS AND LYNN NICHOLAS

We, RICHARD NICHOLAS AND LYNN NICHOLAS, each being of full age, hereby certify follows:

1. We are two (2) of the named Plaintiffs in the within civil action. By way of this certification, we hereby confirm that we reviewed the Amended Class Action Complaint and Demand for Jury Trial. and authorized its filing prior to November 24, 1997. We reviewed the Complaint independent of and in conjunction with Edward M. Bernstein, an Attorney At Law of the State of New Jersey.

2. We did not purchase the security that is the subject of the Amended Class Action Complaint at the direction of Edward M. Bernstein or in order to participate in the within Civil Action.

3. We are each willing to serve as a representative party on behalf of the Class, including providing testimony at deposition(s) and trial, if necessary.

4. We deposited funds with Charles "Chuck" Kohli, Ram Chandra a/k/a Nungambukkam Swamy Ramachandran, Sigma, Inc., and Vol Partners, L.P. from our IRA accounts, 401(K) pension funds and personal savings as follows:

Amount Invested	January 12, 1993	4,000.00
	May 1, 1993	8,000.00
	May 18, 1993	25,000.00
	January 4, 1994	10,000.00
	January 4, 1994	30,000.00
	August, 1994	125,000.00
Amount Returned		$ (39,000.00)
Net Loss		$ (163,000.00)

We lost all but $39,000.00 of their investment as well as improperly charged fees, $213,000.00 in purported profits and unexpected adverse tax consequences. We were required to file bankruptcy in the United States Bankruptcy Court for the District Court of New Jersey due to the aforesaid loss.

5. We have not sought to serve, nor have we served, as a representative party on behalf of a class in any other action filed under Securities Act of 1933 during the period commencing on January 1, 1994 and continuing to the date hereof.

6. We each will not accept any payment for serving as a representative party on behalf of a Class beyond our pro rata share of any recovery, except as otherwise ordered or approved by the Court.

We hereby certify that the foregoing statements made by us are true. We are aware that if any of the foregoing statements made by us are willfully false, we are subject to punishment.

/s/ RICHARD NICHOLAS
Richard Nicholas

/s/ LYNN NICHOLAS
Lynn Nicholas

Dated: November 23, 1997

CERTIFICATION OF ROBERT M. BLACKBURN AND CHERYL S. BLACKBURN

We, ROBERT M. BLACKBURN AND CHERYL S. BLACKBURN, each being of full age, hereby certify as follows:

1. We are two (2) of the named Plaintiffs in the within civil action. By way of this certification, we hereby confirm that we reviewed the Amended Class Action Complaint and Demand for Jury Trial and authorized its filing prior to November 24, 1997. We reviewed the Complaint independent of and in conjunction with Edward M. Bernstein, an Attorney At Law of the State of New Jersey.

2. We did not purchase the security that is the subject of the Amended Class Action Complaint at the direction of Edward M. Bernstein or in order to participate in the within Civil Action.

3. We are each willing to serve as a representative party on behalf of the Class, including providing testimony at deposition(s) and trial, if necessary.

4. We deposited funds with Charles "Chuck" Kohli, Ram Chandran a/k/a Nungambukkam Swamy Ramachandran, Sigma Inc., and Vol Partners, L.P. from our IRA accounts, 401(K) pension funds and personal savings as follows:

Amount Invested	February 24, 1994	$106,306.39
	March 10, 1994	3,946.41
Amount Returned	April 12, 1995	$ (0.00)
Net Loss		$ (110,252.80)

We lost all of our investment as well as improperly charged fees, $133,468.65 in purported profits and unexpected adverse tax consequences.

5. We have not sought to serve, nor have we served, as a representative party on behalf of a class in any other action filed under the Securities Act of 1933 during the period commencing on January 1, 1994 and continuing to the date hereof.

6. We each will not accept any payment for serving as a representative party on behalf of a Class beyond our pro rata share of any recovery, except as otherwise ordered or approved by the Court.

We hereby certify that the foregoing statements made by us are true. We are aware that if any of the foregoing statements made by us are wilfully false, we are subject to punishment.

/s/ ROBERT M. BLACKBURN
Robert M. Blackburn

/s/ CHERYL S. BLACKBURN
Cheryl S. Blackburn

Dated: November 23, 1997

Exhibit "A"

UNITED STATES COURT OF APPEALS
DISTRICT OF NEW JERSEY

Criminal No. 96-132 (AET)

Filed March 6, 1996

7 U.S.C. §§ 60(1) & 13(a)(2); 18 U.S.C. §§1341, 1343 & 2; and 26 U.S.C. § 7201

UNITED STATES OF AMERICA

v.

CHUCKLES KOHLI, a/k/a Chuck Kohli

INFORMATION

The defendant having waived in open court prosecution by indictment, the United States Attorney for the District of New Jersey charges:

COUNT 1
(Commodities Fraud)

1. At all times relevant to this Information:

a. Defendant CHUCKLES KOHLI, a citizen of India and a permanent legal resident of the United States, resided in the Princeton, New Jersey area. Defendant CHUCKLES KOHLI was the principal owner and investment manager of Sigma, Inc. ("Sigma") and The Savid Group ("Savid"), related companies through which he purportedly managed investment funds and commodity portfolios on behalf of individuals, trustees, pension funds and retirement plans. Sigma and Savid shared office space in Princeton, New Jersey.

b. Sigma and Savid were each a "commodity pool operator" as that term is defined in Title 7, United States Code, Section 1a(4) and Title 17, Code of Federal Regulations, Section 1.3(cc).

c. Defendant CHUCKLES KOHLI was an "associated person of a commodity pool operator" as that term is defined in Title 17, Code of Federal Regulations, Section 1.3(aa)(3).

The Scheme to Defraud Sigma/Savid Clients

2. From at least as early as in or about March 1991 to on or about April 12, 1995, at Princeton, in the District of New Jersey, and elsewhere, the defendant

CHUCKLES KOHLI
a/k/a Chuck Kohli,

an associated person of a commodity pool operator, did knowingly and willfully, by direct and indirect use of the mails and other means and instrumentalities of interstate

commerce, employ a device, scheme and artifice to defraud clients and prospective clients of Sigma and Savid, and engage in transactions, practices and a course of business which operated as a fraud and deceit upon clients and prospective clients of Sigma and Savid, which scheme and artifice was in substance as set forth in paragraphs 3 through 34 below.

3. The object of the scheme to defraud existing and prospective clients of Sigma/Savid was for defendant CHUCKLES KOHLI to obtain and retain investor funds by means of false and fraudulent pretenses, representations, and promise concerning himself, Sigma/Savid, and the nature, performance and safety of Sigma/Savid investments. Among the false and fraudulent pretenses, representations, and promises made by defendant CHUCKLES KOHLI are those set forth below.

Misrepresentations Concerning His Educational Background

4. Defendant CHUCKLES KOHLI falsely and fraudulently represented that he had obtained a degree in economics from Columbia University when, in fact, he had attended Columbia University as an undergraduate for only two semesters and had not received a degree of any sort from that institution or from any other college or university.

Misrepresentations Concerning the Investment Experience of Sigma/Savid

5. Defendant CHUCKLES KOHLI falsely and fraudulently represented that both Sigma and Savid were formed and began operations in 1985 when, as defendant CHUCKLES KOHLI knew, Sigma and Savid did not exist and were not managing investments until in or about March 1991.

6. Defendant CHUCKLES KOHLI falsely and fraudulently represented that Sigma/Savid was providing risk management consulting services on over $1 billion in receivables for 25 corporate clients that were all Fortune 100 companies. As defendant CHUCKLES KOHLI knew, Sigma/Savid never provided risk management consulting services for any Fortune 100 companies.

7. Defendant CHUCKLES KOHLI falsely and fraudulently represented that he had brought $15 million in institutional investments to Sigma/Savid from his prior employment at Citibank, and that institutional investment at Sigma/Savid had reached peak of 16 institutional clients, including I.B.M., with $260 million under management. As defendant CHUCKLES KOHLI knew, Sigma/Savid never had more than $1 million in institutional investments under management, and Sigma/Savid had never managed investment funds for I.B.M.

8. Defendant CHUCKLES KOHLI falsely and fraudulently represented that the state retirement system of Virginia and a college retirement fund were Sigma/Savid clients and that Sigma/Savid had $230 million in pension funds under management. As defendant CHUCKLES KOHLI knew, Sigma/Savid never had more than $350,000 in pension funds under management and never had as clients the state retirement system of Virginia or the retirement fund of any college.

Misrepresentations Concerning Registration with Regulatory Authorities

9. Defendant CHUCKLES KOHLI falsely and fraudulently represented that neither Sigma, Savid nor he himself was required to be registered with the Commodity Futures Trading Commission or the New Jersey Bureau of Securities when, as defendant CHUCKLES KOHLI

knew, Sigma and Savid were each required to be registered as a commodity pool operator and he himself was required to be registered as an associated person of a commodity pool operator.

Misrepresentations Concerning Insurance of Savid Investments

10. Defendant CHUCKLES KOHLI falsely and fraudulently represented that Savid investments were fully insured by Lloyds of London ("Lloyds").

11. From in or about March 1991 through in or about January 1993, defendant CHUCKLES KOHLI sent approximately 20 letters to existing and prospective clients concerning insurance on Savid investments with the expectation that these letters would be circulated by the recipients to additional prospective investors. These letters falsely and fraudulently represented as follows:

a. Savid investors were the beneficiaries of insurance policy no. 245-07-4309-18556 underwritten by Lloyds, which insured against any material change in their investment, including the dissolution of Savid or any deterioration in the tangible net worth of the firm;

b. in the event of such a calamity, Savid investors would be able to recover from Lloyds the monetary equivalent of the full value of their investment accounts as determined by their most recent monthly statement; and

c. any claims under the policy could be addressed to Michael Kelleher, the U.S. agent for Lloyds, who could be reached at a specified telephone number in New York City.

12. As defendant CHUCKLES KOHLI knew at the time he sent these letters, Lloyds had never underwritten any

such policy on behalf of Savid investors, and Michael Kelleher, the purported U.S. agent for Lloyds, did not exist.

13. Defendant CHUCKLES KOHLI even went so far as to direct other individuals to assume the identity of the fictitious Michael Kelleher during telephone conversations and meetings with investors to answer questions about the purported Lloyds insurance policy.

Misrepresentations Concerning Sigma/Savid Investment Parameters

14. Defendant CHUCKLES KOHLI falsely and fraudulently represented that all options purchased or sold by Sigma/Savid through commodities clearing firms on behalf of its clients were fully hedged—*i.e.* counterbalanced by an opposite position in the cash market to minimize the risk of financial loss—at the end of each trading day when, as defendant CHUCKLES KOHLI knew, substantial unhedged options positions remained at the end of each day's trading.

15. Defendant CHUCKLES KOHLI falsely and fraudulently represented to Sigma/Savid clients that only 20% of investor funds would be invested or leveraged at any one time while the remaining 80% would be held in a reserve fund. As defendant CHUCKLES KOHLI knew, client monies were invested or leveraged haphazardly without any consideration given to the percentage of any particular client's investment at risk, and these investments were never segregated into active and reserve funds.

16. Defendant CHUCKLES KOHLI falsely and fraudulently represented to Sigma/Savid clients that, if any client account suffered a loss of 2% or more of its total value in any given month, Sigma/Savid would

a. notify all investors of the loss and allow any of them to withdraw the full value of their investment accounts immediately; and

b. temporarily suspend trading to allow for structural changes to be made to the formulas and models that guided investment decisions.

17. As defendant CHUCKLES KOHLI knew, since Sigma/Savid began managing investments in or about March 1991, all client accounts regularly suffered a monthly loss of 2% or more of their total values, yet investors were never notified of these losses, and trading was never suspended to adjust investment strategies.

Misrepresentations Concerning the Nature of Sigma/Savid Investments

18. Defendant CHUCKLES KOHLI falsely and fraudulently represented that Sigma/Savid investors had a choice of allocating their investments to one or more of the following seven investment funds: (a) the Currency Derivative Portfolio; (b) the Currency Portfolio; (c) the Global Fixed Income Portfolio; (d) Capital Growth Portfolio; (e) the Conservative Equity Portfolio; (f) the Diversified Portfolio; and (g) VOL Partners, L.P. According to defendant CHUCKLES KOHLI, the performance of each of these funds differed by virtue of the purported mix of stocks and commodities in each pool and the risk associated with the investment strategies for each pool.

19. Defendant CHUCKLES KOHLI falsely and fraudulently represented that investor monies would be used to purchase "units" of these funds and portfolios, the values of which would be segregated into individual accounts for each investor.

20. As defendant CHUCKLES KOHLI knew, the funds and portfolios listed in paragraph 18 never existed, and investor funds were never segregated into individual accounts. Upon receipt by Sigma/Savid, all investor monies were lumped together into a single corporate account at Carnegie Bank, which was the source of funds utilized by defendant CHUCKLES KOHLI to conduct daily trading activity with commodities clearing firms as well as to pay his business and personal expenses.

Misrepresentations Concerning the Performance of Sigma/Savid Investments

21. In promotional literature of Sigma/Savid, defendant CHUCKLES KOHLI falsely and fraudulently represented monthly and annual rates of return for the non-existent funds and portfolios listed in paragraph 18 from January 1985 through February 1991, a period prior to the establishment of either Sigma or Savid. Defendant CHUCKLES KOHLI boasted of annual returns during this period for these non-existent funds and portfolios as high as 90.57% but never lower than 14.49%, returns that significantly outperformed the Standard & Poor 500 Index for the relevant periods.

22. Defendant CHUCKLES KOHLI falsely and fraudulently represented that, during the period from March 1991 through April 1995, all the non-existent funds and portfolios listed in paragraph 18 appreciated in value each and every month with a few minor exceptions in 1991 and early 1992. These monthly figures translated into purported annual returns across the spectrum of the non-existent funds and portfolios averaging approximately 50%, and annual returns for the most aggressive of these non-existent funds and portfolios as high as 132.32%.

23. From at least as early as in or about November 1992 through in or about March 1995, defendant CHUCKLES KOHLI, at the beginning of each calendar month, sent every Sigma/Savid client a letter and account statement falsely and fraudulently reporting appreciation in that client's investment account and projecting an annual return based upon the reported appreciation of the previous calendar months.

24. Defendant CHUCKLES KOHLI extracted a management fee from every Sigma/Savid client amounting to 25% of the supposed appreciation in their investment accounts as detailed in the monthly letters and account statements.

25. As defendant CHUCKLES KOHLI knew, Sigma/Savid monthly commodity trading activity yielded loss rather than profit in all but nine disparate months during the entire period from March 1991 through April 1995. Defendant CHUCKLES KOHLI was also well aware that, despite these few marginally profitable trading months, Sigma/Savid accumulated net trading losses continuously from November 1991 through April 1995, resulting in total trading losses of approximately $19.5 million.

Misrepresentations Concerning the Purchase of Zero Coupon Bonds

26. Defendant CHUCKLES KOHLI falsely and fraudulently offered two Sigma/Savid clients investment options outside the non-existent funds and portfolios listed in paragraph 18. At defendant CHUCKLES KOHLI'S suggestion, these two individuals provided him with a total of $300,000 to purchase zero coupon bonds denominated in U.K. Sterling with a coupon income of 8.98% and a maturity date in the year 2000. Defendant CHUCK-

LES KOHLI never purchased any zero coupon bonds on behalf of these investors, yet from in or about January 1993 through in or about March 1995, he sent them monthly account statements falsely and fraudulently reporting the continuous appreciation of their zero coupon bond investment.

Misrepresentations Concerning the Confidential Nature of Personal Data on Applications

27. Defendant CHUCKLES KOHLI falsely and fraudulently advised prospective Sigma/Savid clients that personal data submitted on investment application forms, such as Social Security number, date of birth, annual income and net worth, would be kept strictly confidential.

28. In or about October 1991, defendant CHUCKLES KOHLI applied for a corporate American Express card in the name of a Savid investor without that investor's knowledge or consent. Defendant CHUCKLES KOHLI completed the credit card application with personal data provided by the investor on his Savid investment application form.

29. Based upon the application, American Express issued a corporate card in the name of the investor and established a billing address for this card at defendant CHUCKLES KOHLI's personal residence. Defendant CHUCKLES KOHLI used this American Express card to charge his travel, dining and entertainment expenses related to Sigma/Savid business.

Forging Commodity Clearing Firm Statements

30. On or about December 27, 1994, a Savid investor expressed concern that his accountant had been unable to verify the full value of the investor's personal and cor-

porate investments with Savid. In an effort to assuage this concern, defendant CHUCKLES KOHLI met with the accountant at the Sigma/Savid offices on or about February 1, 1995. At that meeting, defendant CHUCKLES KOHLI provided the accountant with a forged December 1994 year end statement from the commodity clearing firm GNI Limited, which falsely and fraudulently showed a $17.7 million cash balance for Savid as of December 30, 1994.

31. In or about December 1994, defendant CHUCKLES KOHLI caused the printing of dozens of blank statement forms similar to those used by the commodity clearing firms GNI Limited and Saul Stone & Company so that he could create forged statements similar to the one described in paragraph 30 and provide those statements to other inquisitive investors.

Giving Preferential Treatment to Family Member Investors

32. In or about February 1995, when it became clear that the massive trading losses and insolvency of Sigma/Savid would soon be discovered, defendant CHUCKLES KOHLI suggested to his sister and her husband that they should completely liquidate their Sigma/Savid accounts. At this time, defendant CHUCKLES KOHLI permitted them to withdraw their entire principal as well as some of the supposed interest earned on this investment.

33. As a result of the scheme to defraud existing and prospective clients of Sigma/Savid, defendant CHUCKLES KOHLI obtained a total of approximately $41 million from investors. Approximately $19.5 million was lost by defendant CHUCKLES KOHLI while engaged in commodity trading, including commissions paid to commodity clearing firms. Approximately $7.9 million was

spent by defendant CHUCKLES KOHLI on the operating expenses of Sigma/Savid. Approximately $2 million was transferred by defendant CHUCKLES KOHLI into personal accounts controlled by he and/or his then wife. The remaining $11.6 million was primarily comprised of withdrawals by Sigma/Savid investors from their investment accounts, but also included finders fees paid by defendant CHUCKLES KOHLI to existing Sigma/Savid investors to recruit new investors. The net result is that Sigma/Savid investors as a whole were defrauded of approximately $30 million.

34. To date, only approximately $1.4 million of investor funds have been recovered by John Manley, the court-appointed equity receiver for Sigma/Savid. Approximately $600,000 was realized from Sigma/Savid bank accounts and the liquidation of open trading positions placed by defendant CHUCKLES KOHLI. The remaining $800,000 was obtained by Manley pursuant to a settlement with defendant CHUCKLES KOHLI's ex-wife.

All in violation of Title 7, United States Code, Sections 60(1) and 13(a)(2).

COUNT 2
(Wire Fraud)

1. The allegations set forth in paragraphs 1(a) and 3 through 34 of Count 1 of this Information are realleged as if set forth herein at length.

2. From at least as early as in or about March 1991 to on or about April 12, 1995, at Princeton, New Jersey, and elsewhere, the defendant CHUCKLES KOHLI devised and intended to devise a scheme and artifice to defraud clients and prospective clients of Sigma and Savid and to obtain money and property of clients and prospective clients of Sigma and Savid by means of false and fraudulent pretenses, representations and promises, which scheme and artifice was in substance as set forth in paragraphs 3 through 34 of Count 1 of this Information.

3. On or about September 16, 1991, for the purpose of executing said scheme and artifice, at Princeton, in the District of New Jersey, and elsewhere, the defendant

CHUCKLES KOHLI
a/k/a Chuck Kohli,

knowingly and willfully caused a copy of the letter described in paragraph 11 of Count 1 of this Information to be transmitted via facsimile machine from the offices of Sigma/Savid in Princeton, New Jersey to Gerald Johnson, president of Campbell & George Company, in San Carlos, California.

In violation of Title 18, United States Code, Sections 1343 and 2.

COUNT 3
(Mail Fraud)

1. The allegations set forth in paragraphs 1(a) and 3 through 34 of Count 1 of this Information are realleged as if set forth herein at length.

2. From at least as early as in or about March 1991 to on or about April 12, 1995, at Princeton, New Jersey, and elsewhere, the defendant CHUCKLES KOHLI devised and intended to devise a scheme and artifice to defraud clients and prospective clients of Sigma and Savid and to obtain money and property of clients and prospective clients of Sigma and Savid by means of false and fraudulent pretenses, representations and promises, which scheme and artifice was in substance as set forth in paragraphs 3 through 34 of Count 1 of this Information.

3. On or about April 23, 1993, for the purpose of executing said scheme and artifice, and attempting to do so, at Princeton, in the District of New Jersey, and elsewhere, the defendant

CHUCKLES KOHLI
a/k/a Chuck Kohli,

knowingly and willfully caused to be placed in a post office and an authorized depository for mail matter, and caused to be delivered by mail according to the direction thereon, an envelope addressed to Rosalyn Golaine, 11 Old Stable Road, Demarest, New Jersey 07627, containing a letter falsely and fraudulently reporting that he had purchased on her behalf $100,000 in zero coupon bonds denominated in U.K. Sterling with a coupon income of 8.98% and a maturity date in December 2000.

In violation of Title 18, United States Code, Sections 1341 and 2.

COUNT 4
(Mail Fraud)

1. The allegations set forth in paragraphs 1(a) and 3 through 34 of Count 1 of this Information are realleged as if set forth herein at length.

2. From at least as early as in or about March 1991 to on or about April 12, 1995, at Princeton, New Jersey, and elsewhere, the defendant CHUCKLES KOHLI devised and intended to devise a scheme and artifice to defraud clients and prospective clients of Sigma and Savid and to obtain money and property of clients and prospective clients of Sigma and Savid by means of false and fraudulent pretenses, representations and promises, which scheme and artifice was in substance as set forth in paragraphs 3 through 34 of Count 1 of this Information.

3. On or about March 1, 1995, for the purpose of executing said scheme and artifice, and attempting to do so, at Princeton, in the District of New Jersey, and elsewhere, the defendant

CHUCKLES KOHLI
a/k/a Chuck Kohli,

knowingly and willfully caused to be placed in a post office and an authorized depository for mail matter, and caused to be delivered by mail according to the direction thereon, an envelope addressed to Michael and Susan Lamore, 3602 Chadford Place, Greensboro, North Carolina 27410, containing a letter and monthly account statement falsely and fraudulently reporting that their Savid investment account had appreciated 8.1% during the month of February 1995 and projecting an annual return of 99.45% for the calendar year 1995.

In violation of Title 18, United States Code, Sections 1341 and 2.

COUNT 5
(1992 Income Tax Evasion)

1. The allegations set forth in paragraphs 1(a) of Count 1 of this Information are realleged as if set forth herein at length.

2. At all times relevant to this Information, defendant CHUCKLES KOHLI:

a. treated all the employees of Sigma/Savid, including himself, as independent contractors with the consequence that he did not withhold taxes from salaries and did not issue Forms W-2;

b. handled the affairs of Sigma/Savid to avoid making and keeping records usually connected with a business, including payroll books and records; and

c. diverted funds of Sigma/Savid investors to the personal use of himself and his then wife.

3. During the calendar year 1992, defendant CHUCKLES KOHLI had and received taxable income of about $359,387.39 from Sigma/Savid investor funds, and upon this taxable income, a tax of about $104,161.09 was due and owing to the United States.

4. At no time on or before April 15, 1993 did defendant CHUCKLES KOHLI file a United States Individual Income Tax Return, Form 1040, for the calendar year 1992.

5. On or about April 15, 1993, in Mercer County, in the District of New Jersey, and elsewhere, the defendant

CHUCKLES KOHLI
a/k/a Chuck Kohli,

knowingly and willfully did attempt to evade and defeat a substantial part of the income tax due and owing by him to the United States for the calendar year 1992.

In violation of Title 26, United States Code, Section 7201.

COUNT 6
(1993 Income Tax Evasion)

1. The allegations set forth in paragraphs 1 and 2 of Count 5 of this Information are realleged as if set forth herein at length.

2. During the calendar year 1993, defendant CHUCKLES KOHLI had and received taxable income of about $369,561.91 from Sigma/Savid investor funds, and upon this taxable income, a tax of about $122,875.02 was due and owing to the United States.

4. At no time on or before April 15, 1994 did defendant CHUCKLES KOHLI file a United States Individual Income Tax Return, Form 1040, for the calendar year 1993.

5. On or about April 15, 1994, in Mercer County, in the District of New Jersey, and elsewhere, the defendant

CHUCKLES KOHLI
a/k/a Chuck Kohli,

knowingly and willfully did attempt to evade and defeat a substantial part of the income tax due and owing by him to the United States for the calendar year 1993.

In violation of Title 26, United States Code, Section 7201.

COUNT 7
(1994 Income Tax Evasion)

1. The allegations set forth in paragraphs 1 and 2 of Count 5 of this Information are realleged as if set forth herein at length.

2. During the calendar year 1994, defendant CHUCKLES KOHLI had and received taxable income of about $247,671.02 from Sigma/Savid investor funds, and upon this taxable income, a tax of about $74,466.07 was due and owing to the United States.

4. At no time on or before April 17, 1995 did defendant CHUCKLES KOHLI file a United States Individual Income Tax Return, Form 1040, for the calendar year 1994.

5. On or about April 17, 1995, in Mercer County, in the District of New Jersey, and elsewhere, the defendant

CHUCKLES KOHLI
a/k/a Chuck Kohli,

knowingly and willfully did attempt to evade and defeat a substantial part of the income tax due and owing by him to the United States for the calendar year 1994.

In violation of Title 26, United States Code, Section 7201.

/s/ Faith S. Hochberg
FAITH S. HOCHBERG
United States Attorney

Exhibit B-1

VOL PARTNERS, L.P.

POWER OF ATTORNEY

Vol Partners, L.P. c/o Mr. Chuck Kohli, 205 Nassau Street, Princeton, N.J. 08540.

1993

Dear Sir:

In connection with my interest in VOL PARTNERS, L.P. (the "Partnership") I do hereby irrevocably constitute and appoint Mr. Chuck Kohli (the "General Partner") as my true and lawful Attorney-in-Fact, with full power of substitution, in my name, place and stead, to execute, acknowledge and swear to (i) the Limited Partnership Agreement of the Partnership, and (ii) such Powers of Attorney and other account forms as shall be required by the Partnership's Clearing Firm and Bank.

The Power of Attorney granted herein shall be irrevocable and deemed to be a power coupled with an interest and shall survive the incapacity or death of a Partner. Each Partner agrees to be bound by representations made by the General Partner and by any successor thereto, acting in good faith pursuant to such Power of Attorney, and each Partner hereby waives any and all defenses which may be available to contest, negate or disaffirm

the action of the General Partners taken pursuant to this Power of Attorney.

/s/ [ILLEGIBLE]
Individual Partner

Entity Partner

(Name of Entity)

By
(Authorized trustee, partner or corporate officer)

Exhibit B-1

VOL PARTNERS, L.P.

POWER OF ATTORNEY

Vol Partners, L.P., c/o Sigma Inc., 210 Carnegie Center Ste 102 Princeton, N.J. 08540.

1994

Dear Sir:

In connection with my interest in VOL PARTNERS, L.P. (the "Partnership") I do hereby irrevocably constitute and appoint Sigma Inc. (the "General Partner") as my true and lawful Attorney-in-Fact, with full power of substitution, in my name, place and stead, to execute, acknowledge and swear to (i) the Limited Partnership Agreement of the Partnership, and (ii) such Powers of Attorney and other account forms as shall be required by the Partnership's Clearing Firm and Bank.

The Power of Attorney granted herein shall be irrevocable and deemed to be a power coupled with an interest and shall survive the incapacity or death of a Partner. Each Partner agrees to be bound by representations made by the General Partner and by any successor thereto, acting in good faith pursuant to such Power of Attorney, and each Partner hereby waives any and all defenses which may be available to contest, negate or disaffirm

the action of the General Partner taken pursuant to this Power of Attorney.

/s/ [ILLEGIBLE]
Individual Partner

Entity Partner

(Name of Entity)

By
(Authorized trustee, partner or corporate officer)

Exhibit B-1

VOL PARTNERS, L.P.

POWER OF ATTORNEY

Vol Partners, L.P., c/o Sigma Inc., 210 Carnegie Center Ste 102 Princeton, N.J. 08540.

1995

Dear Sir:

In connection with my interest in VOL PARTNERS, L.P. (the "Partnership") I do hereby irrevocably constitute and appoint Sigma Inc. (the "General Partner") as my true and lawful Attorney-in-Fact, with full power of substitution, in my name, place and stead, to execute, acknowledge and swear to (i) the Limited Partnership Agreement of the Partnership, and (ii) such Powers of Attorney and other account forms as shall be required by the Partnership's Clearing Firm and Bank.

The Power of Attorney granted herein shall be irrevocable and deemed to be a power coupled with an interest and shall survive the incapacity or death of a Partner. Each Partner agrees to be bound by representations made by the General Partner and by any successor thereto, acting in good faith pursuant to such Power of Attorney, and each Partner hereby waives any and all defenses which may be available to contest, negate or disaffirm the action of the General Partners taken pursuant to this Power of Attorney.

/s/ [ILLEGIBLE]
Individual Partner

Entity Partner

(Name of Entity)

By
(Authorized trustee, partner or corporate officer)

[LETTERHEAD OF SIGMA INC]

VOL PARTNERS L.P.

EXHIBIT "C"

VOL PARTNERS L.P.

Limited Partnership Agreement

This Limited Partnership Agreement made in Princeton, N.J., as of the _____ day of ____, by and between Sigma Inc. as General Partner and each other party who shall execute a counterpart of this Agreement as a limited partner or who becomes a party to this Agreement as a limited partner by execution of a separate instrument or otherwise (individually "Limited Partner" or collectively "limited partners") (the General Partners and limited partners may be collectively referred to herein as "Partners"):

WITNESSETH:

WHEREAS, the parties hereto desire to form a limited partnership for the purpose of trading in derivative securities for speculative gain as described below:

NOW, THEREFORE, the parties hereto agree as follows:

1. Formation and Name.

The parties hereto do hereby form a limited partnership. The name of the limited partnership is Vol Partners, L.P. (the "Partnership").

2. Principal Place of Business.

The principal office of the Partnership shall be in care of the General Partner, Sigma Inc., 101 Carnegie Center, Ste. 203, Princeton, N.J. 08540, or such other place as the General Partner may designate from time to time.

3. Business.

The Partnership business and purpose is to trade, buy, sell or otherwise acquire, hold or dispose of derivative securities (including index options, foreign currencies, and foreign currency options), and other rights pertaining thereto. The objective of the Partnership is the appreciation of its assets through speculative trading.

4. Term, Dissolution, Fiscal Year and Certain Definitions.

(a) Term. The Partnership shall commence on the first day of January, 1992, and shall continue for a period ending on the first to occur of the following:

(i) December 31, 1995.

(ii) An election to dissolve the Partnership at any time by limited partners owning more than 50% of the Units of limited partnership interest then outstanding, notice of which is sent by registered mail to the General Partner not less than 60 days prior to the effective date of such dissolution.

(iii) A decline in Net Assets of the Partnership (defined below) of 20% of initial capital contributions.

(iv) Any event which shall make unlawful the continued existence of the Partnership.

(b) Dissolution. Upon the first to occur of the above events, the Partnership shall terminate and be dissolved. Dissolution, payment of creditors and distribution of the Partnership assets shall be effected such that the General Partner and each limited partner (and any assignee) shall share in the assets of the Partnership pro rata in accordance with their respective interests, less any amount owing by such Partner (or assignee) to the Partnership.

(c) Fiscal Year. The fiscal year of the Partnership shall begin on January 1 of each year and end on the following December 31.

(d) Certain Definitions. Net Assets of the Partnership shall mean the sum of all cash, United States Treasury bills and other securities (valued at cost plus accrued interest), the liquidating value of all derivative securities positions and other assets of the Partnership, as determined by the General Partner on a basis consistently applied, less all liabilities of the Partnership including all brokerage charges which would be incurred in liquidating the Partnership's open positions and all management, and incentive fees payable by the Partnership; in each case as determined in accordance with generally accepted accounting principles under the accrual basis of accounting, except as described here. The liquidating value of derivative securities position shall mean its liquidating value as determined by the General Partner on a basis consistently applied. The Net Asset Value of a Unit shall mean the net assets allocated to capital accounts represented by Units of limited partnership interest divided by the number of such Units outstanding.

5. Units of Limited Partnership Interest and Capital Contributions.

Interests in the Partnership shall be Units of limited partnership interest (a "Unit"). The General Partner may, on behalf of the Partnership issue and sell additional Units at net asset value giving the remaining limited partners the right to participate therein.

If the Partnership shall not have obtained during the period of the initial offering of the Units ("Initial offering Period") subscriptions for at least 100 Units ($100,000), this Agreement shall terminate, and all capital contributed to the Partnership shall be promptly returned to the contributors thereof undiminished and with interest allocated on an equitable basis as determined by the General Partner. The Partnership shall not commence trading operations unless and until the General Partners have accepted subscriptions for at least 100 Units ($100,000). The General Partners may terminate any offering of Units at any time.

6. Allocation of Profits, Losses, and Fees.

(a) Capital Accounts. A capital account shall be established for each Partner. The initial balance of each Partner's capital account shall be the amount of his initial contribution to the Partnership.

(b) Allocations; Valuation Dates. The last day of the first calendar month or portion thereof of trading operations of the Partnership and the last day of each month thereafter during the term of the Partnership are each considered to be a "Valuation Date." As of the close of business (as determined by the General Partner) on each Valuation Date and on each Special Redemption Date, the net asset value

of the units shall be made and reported to the partners.

(c) Allocation of Profit and Loss for Federal Income Tax Purposes. As of the end of each fiscal year, the Partnership's profit or loss shall be allocated among the Partners, including the General Partners, pursuant to the following subparagraphs for federal income tax purposes. Such allocations of profit and loss will be pro rata from net short-term capital gain or loss, net long-term gain or loss and net operating income or loss realized by the Partnership.

(i) Net realized profit shall be allocated to each Partner who has redeemed Units during the year to the extent that the amount the Partner received on redemption of Units exceeds the amount paid for the redeemed Units.

(ii) Net realized profit remaining after the allocation in subparagraph (i) above shall be allocated among all Partners in the ratio that each Partner's capital account bears to all Partners' capital accounts.

(iii) Net realized loss shall be allocated first to each Partner who has redeemed Units during the year to the extent the amount the Partner paid for the Units exceeds the amount he receives on redemption or withdrawal.

(iv) Net realized loss remaining after the allocation in subparagraph (iii) above shall be allocated among all Partners in the ratio that each Partner's capital account bears to all Partners' accounts.

(v) For the purpose of the allocations of realized profit and loss in subparagraphs (i) and (iii) above, the amount each Partner paid for each of his Units shall be deemed to have increased by the amount of realized profit allocated to the Partner with respect to such Unit and decreased by any distribution and by the amount of any loss allocated to the Partner with respect to such Unit.

(d) Fees. The Partnership shall be charged all brokerage commissions and exchange fees at rates to be negotiated by the General Partner with a clearing firm selected by the General Partner. The Partnership will pay Sigma Inc., General Partner, twenty-five percent of the profit achieved by the partnership. This management fee will accrue monthly and will be payable quarterly. One of the limited partners is a securities broker who will be an equity participant as well as a recipient of commissions, the amount of which will be determined by the General Partner.

(e) Limited Liability of Limited Partners. Each Unit, when purchased in accordance with this Agreement, shall be fully paid and nonassessable. Any provisions of this Agreement to the contrary notwithstanding, no limited partner shall be liable for Partnership obligations in excess of the capital contributed by him, plus his share of profits remaining in the Partnership.

(f) Return of Limited Partner's Capital Contribution. Each Partner agrees not to request for return of profits or initial capital contributions for at least twelve months from the commencement of operation.

7. Management of the Partnership.

The General Partner, to the exclusion of all limited partners, shall conduct and manage the business of the Partnership, including, without limitation, the investment of the funds of the Partnership. The General Partner shall have sole discretion in determining what distributions of profits and income, if any, shall be made to the Partners, shall execute various documents on behalf of the Partnership and the Partners pursuant to powers of attorney and supervise the liquidation of the Partnership if agent causing termination of the Partnership occurs. In order to facilitate the foregoing, each limited partner shall execute a power of attorney as described in Exhibit B.

The General Partner may, in furtherance of the business of the Partnership, cause the Partnership to buy, sell, hold, otherwise acquire or dispose of equity index options, foreign currencies, and foreign currency options.

The General Partner may take such other actions on behalf of the Partnership as it deems is necessary to manage the business of the Partnership including, but not limited to, the following: opening bank accounts and paying, or authorizing the payment of, distributions to the Partners and expenses of the Partnership such as management fees described in section 6(d) of the Limited Partnership Agreement, and brokerage commissions. The General Partner shall have a fiduciary responsibility to the Partnership with respect to the safekeeping and use of all funds and assets of the Partnership, whether or not in its immediate possession and control.

The General Partner is engaged in other business activities and shall not be required to refrain from any other activity nor forego any profits from any such activity, whether as limited partner of any other entity, trad-

ing for its own individual account or trading advisor to additional partnerships for investment in derivative securities, or otherwise.

8. Reports to Limited Partners.

The Partnership will use its best efforts to cause each Partner to receive within 75 days of the end of each fiscal year of the Partnership such tax information as is necessary for him to complete his federal income tax return. In addition, the General Partners will report or cause to be reported monthly to the limited partners the following information: The Net Asset Value of a Unit as of the end of the month, as of the end of the previous month, and as of the inception of the partnership, and the percentage change in Net Asset Value of a Unit between the two months and as of the year to date; the amount of additions, redemptions or distributions during the month, and the aggregate brokerage commissions and management fees incurred or accrued by the Partnership during the month.

9. Redemption of Units of Limited Partnership Interest; Non-Assignability of Units and Suspension of Trading in Certain Events.

Except as set forth herein, each limited partner expressly agrees that he will not assign, transfer or dispose of, by gift or otherwise, any of his Units or any part or all of his right, title and interest in the capital or profits of the Partnership and that any such purported disposition is void; provided, however, that any individual limited partner may assign Units by will or by virtue of the laws of descent and distribution, any beneficial owner of a Unit registered in the name of a nominee may revoke nominee status, and any limited partner which is a corporation, partnership, trust or other entity may,

upon liquidation, dissolution or other termination thereof, assign Units to the shareholders, partners, beneficiaries or other beneficial owners thereof. No assignee may become a substituted limited partner nor will the estate of any beneficiary of a deceased limited partner have any right to withdraw any capital or profits from the Partnership except by redemption of Units. Each limited partner agrees that he has no right to consent to and will not consent to any person or entity becoming a substituted Limited Partner.

Assignment of Partnership interests shall be permitted, provided that such assignment will not cause the Partnership to be taxable as a corporation or an association rather then as a partnership under the policies of the Internal Revenue Service. In any event each assignment must be for at least the minimum subscription amount stated in the Partnership's offering documents and each assignee must meet minimum investor suitability standards set forth in the offering documents.

A limited partner (or assignee of Units) may withdrew from the Partnership all or any part of his capital contribution and undistributed profits, if any (such withdrawal being herein referred to as "redemption"), by requiring the Partnership to redeem any or all of his Units at the Net Asset Value of a Unit, calculated as of the close of business (as determined by the General Partners) on the date immediately preceding the effective date of redemption, as of the first day of any quarter, after the first twelve months of investing in the partnership; provided, that (i) all liabilities, contingent or otherwise, of the Partnership, except any liability to Partners on account of their capital contributions, have been paid or there remains property of the Partnership sufficient to pay them, (ii) the General Partners shall have timely received a Request for Redemption as hereinafter defined, and (iii) that the requested redemption

shall not reduce the net assets of the partnership to less then the initial capital contribution of the partners. As used herein, Request for Redemption shall mean a letter in the form specified by the General Partners sent by a limited partner (or any assignee thereof) and received by the General Partner at least ninety days (or such lesser period acceptable to the General Partner) prior to the requested effective date of redemption. A form of Request for Redemption is included as an exhibit to the initial documents. Additional forms of Request for Redemption may be obtained by written request to the General Partner. The General Partners may declare additional redemption dates upon notice to the limited partners. Upon redemption, a Partner (or any assignee thereof) shelf receive from the Partnership for each whole Unit redeemed an amount equal to the Net Asset Value of a Unit, less the amount owing by such Partner (and his assignee, if any) to the Partnership pursuant to Paragraph 9 hereof. If redemption is requested by an assignee, all amounts owed under Paragraph 9, by the Partner to whom such Unit was sold by the Partnership as well as all amounts owed by all assignors who owned such Unit shall be deducted from the amount paid to such assignee upon redemption of his Units.

10. Withdrawal of General Partner.

The General Partner may withdraw from the Partnership at any time after 12 months from the inception of the partnership on ~~90 days~~ written notice by first class mail, postage prepaid, to each Limited Partner. In that event or in the event of the death, or incompetency of the General Partner, the Partnership shall terminate and be dissolved; provided, however, that the remaining limited partners may elect a replacement general partner in the event of such withdrawal. The death, incompetency,

or withdrawal of a limited partner shall not terminate or dissolve the Partnership and Such Limited Partner, his estate, custodian or personal representative shall have no right to withdraw or value such Limited Partner's interest in the Partnership except as provided in Paragraph 10 hereof.

11. No Personal Liability for Return of Capital.

The General Partner shall not be personally liable for the return or repayment of all or any portion of the capital or profits of any Partner (or assignee), it being expressly agreed that any such return of capital or profits will be made solely from the assets (which shall not include any right of contribution from the General Partner) of the Partnership.

12. Indemnification.

(a) The General Partner and Affiliates shall have no liability to the Partnership or to any Partner for any loss suffered by the Partnership which arises out of any action or inaction of the General Partner or Affiliates if the General Partner or Affiliates, in good faith, determined that such course of conduct was in the best interests of the Partnership and such course of conduct did not constitute negligence or misconduct of the General Partner or Affiliates. The General Partner and Affiliates shall be indemnified by the Partnership against any losses, judgments, liabilities, expenses and amounts paid in settlement of any claims sustained by them in connection with the Partnership. provided that the same were not the result of negligence or misconduct on the part of the General Partners or their Affiliates and arose in connection with the Partnership.

(b) Notwithstanding the above, the General Partner and Affiliates and any person acting as a broker-dealer shall not be indemnified for any losses, liabilities or expenses arising from or out of an alleged violation of federal or state securities laws unless (1) there has been a successful adjudication on the merits of each count involving alleged securities law violations as to the particular indemnitee, or (2) such claims have been dismissed with prejudice on the merits by a court of competent jurisdiction as to the particular indemnitee or (3) a court of competent jurisdiction approves a settlement of the claims against a particular indemnitee.

13. Amendments; Meetings.

(a) Amendments With Consent of the General Partner. If at any time during the term of the Partnership the General Partner deem it necessary or desirable to amend this Agreement, such amendment shall be effective only if embodied in an instrument signed by the General Partner and by the limited partners owning more than 50% of the Units then owned by limited partners. Any such supplemental or amendatory agreement shall be adhered to and have the same effect from and after its effective date as if the same had originally been embodied in and formed a part of this agreement, provided, however, that no such supplemental or amendatory agreement shall, without the consent of all limited partners, change or alter this Paragraph 13, extend the term of the Partnership, reduce the capital account of any Partner, modify the percentage of profits, losses or distributions to which any Partner is entitled. In addition, reduction of the capital account of any assignee or modification of the percentage of prof-

its, losses or distributions to which an assignee is entitled hereunder shall not be affected by amendment or supplement to this Agreement without such assignee's consent.

(b) Meetings. Any Limited Partner, upon written request addressed to the General Partner, shall be entitled to obtain from the General Partners a list of the names and addresses of record of all limited partners and the number of Units held by each. Upon receipt of a written request, signed by limited partners owning at least 50% of the Units then owned by limited partners, that a meeting of the Partnership be called to vote upon any matter which the limited partners may vote upon pursuant to this Agreement, the General Partner shall, by written notice to each limited partner of record mailed within 15 days after such receipt, call a meeting of the Partnership. Such meeting shall be held at least 30 days, but not more than 50 days after the mailing of such notice, and such notice shall specify the date, a reasonable place and time, and the purpose of such meeting.

14. Governing Law.

The validity and construction of this Agreement shall be determined and governed by the laws of the State of New Jersey.

15. Miscellaneous.

(a) Priority Among limited partners. No limited partners shall be entitled to any priority or preference over any other limited partner in regard to the affairs of the Partnership.

(b) Notices. Except for Requests for Redemption, all notices under this Agreement shall be in writing and shall be effective upon personal delivery, or if sent by first class mail, postage prepaid, addressed to the last known address of the party to whom such notice is to be given, then, upon the deposit of such notice in the United States mails. Requests for Redemption shall be effective upon timely receipt by the General Partner.

(c) Binding Effect. This Agreement shall inure to and be binding upon all of the parties, their successors in interest, assigns as permitted herein, custodians, estates, heirs and personal representatives. For purposes of determining the rights of any Partner or assignee hereunder, the Partnership and the General Partners may rely upon the Partnership records as to who are Partners and assignees and all Partners and assignees agree their rights shall be determined and that they shall be bound thereby, including all rights which they may have under Paragraph 14 hereof.

(d) Captions. Captions in no way define, limit, extend or describe the scope of this Agreement nor the effect of any of its provisions.

GENERAL PARTNER:

IN WITNESS WHEREOF the parties have executed this Agreement as of the

LIMITED PARTNER:

_____
(Name of Limited Partner)

_____
Sigma, Inc., General Partner
By Chuck Kohli, President of Sigma, Inc.
Attorney-in-Fact for the Limited Partner named above

_____
Date of Signature:

EXHIBIT B

Subscribers should complete and sign one copy of each of the Subscription Agreement, and the Power of Attorney (Exhibit "B-1")

VOL PARTNERS, L.P.

SUBSCRIPTION AGREEMENT

Sigma Inc., General Partner, VOL Partners L.P., 101 Carnegie Center, Ste 203, Princeton, N.J. 08540

Gentlemen

1. Subscription. Subject to the terms and conditions of this Agreement, the undersigned hereby irrevocably subscribes for and agrees to purchase _____ Units of Limited Partnership Interest, (the "Units") of Vol Partners, L.P., (the "Partnership"). The undersigned is delivering to the Partnership herewith (i) the undersigned's check, payable to the order of Sigma, Inc. in the amount of $_____ representing the aggregate purchase price of as many Units as such funds will purchase, fractional units included, (ii) a completed and duly executed Power of Attorney, in the form attached to the Memorandum as Exhibit B-1.

2. Acceptance of Subscription. The undersigned acknowledges that the General Partner reserves the right, in his sole and absolute discretion, to accept or reject this subscription, in whole or in part, and that this subscription shall not be binding unless and until accepted by the General Partner. The undersigned agrees that sub-

scriptions need not be accepted in the order they are received.

3. Representations and Warranties. The undersigned represents and warrants to the Partnership as follows:

(a) The General Partner has answered all inquiries that the undersigned has made of it concerning the Partnership, its business and financial condition or any other matter relating to the operation of the Partnership and the offering and sale of the Units. No oral or written statement or inducement which is contrary to the information set forth in the Memorandum has been made by or on behalf of the Partnership to the undersigned.

(b) The undersigned is an "accredited investor" or the undersigned has such knowledge and experience in financial and business matters to enable him to utilize the information made available to him in connection with the offering of the Units, to evaluate the merits and risks of the prospective investment, and to make an informed investment decision with respect thereto.

(c) The undersigned (i) has adequate means of providing for his current needs and possible personal contingencies, (ii) has no need for liquidity in this investment, (iii) is able to bear the economic risks of his investment in the Units and (iv) at the present time, can afford a complete loss of such investment.

(d) The undersigned is purchasing the Units for investment and not for distribution, assignment or resale to others, and no other person has any direct or indirect beneficial interest in such Units.

(e) The undersigned, if a corporation, partnership, trust or other entity, is organized under the laws of a state of the United States, and is authorized and otherwise duly qualified to purchase and hold the Units, and

such entity has its principal place of business at the address set forth on the signature page hereof.

(f) The undersigned, if an individual, is a citizen of the United States of America or a resident alien, is a least 21 years of age, and has the legal capacity to execute, deliver and perform this Agreement.

(g) All information which the undersigned has provided to the General Partner concerning himself, his financial position and his knowledge of financial and business matters, or, in the case of a corporation, partnership, trust or other entity, the knowledge of financial and business matters of the person making the investment decision on behalf of such entity, including all information contained herein is true and complete as of the date set forth at the end hereof, and if there should be any adverse change in such information prior to this subscription being accepted, the undersigned will immediately provide the General Partner with accurate and complete information concerning any such change.

(h) The undersigned certifies, under penalties of perjury, (i) that the social security or federal taxpayer identification number shown on the signature page of this Agreement is true and complete and (ii) that the undersigned is not subject to backup withholding either because the undersigned has not been notified that he is subject to backup withholding as a result of a failure to report all interest or dividends, or the Internal Revenue Service has notified the undersigned that he is no longer subject to backup withholding.

(i) The undersigned understands that brokerage commissions will be charged to the Partnership and that the General Partner for the Partnership will charge the Partnership for management fees as described in section 7(d) of the Limited Partnership Agreement.

(j) The undersigned understands that the undersigned can withdraw the undersigned's contributed capital from the Partnership on ninety days written notice to the General Partner on the first day of any quarter after the first twelve months of investing in the partnership and that the undersigned has no right to demand distributions from the Partnership prior to the termination, other than by redemption of Units.

4. Acceptance of Limited Partnership Agreement. The undersigned hereby agrees to each and every term of the Limited Partnership Agreement as if the undersigned's signature were subscribed thereto. The undersigned hereby appoints the General Partner as the undersigned's attorney-in-fact to subscribe the undersigned's name to the Limited Partnership Agreement.

5. Indemnification. The undersigned agrees to indemnify and hold harmless the General Partner from and against any and all damage, loss, liability, cost and expense (including attorneys' fees) which the General Partner may incur by reason of failure by the undersigned to fulfill any of the terms or conditions of this Agreement or in any other document provided by the undersigned to the General Partner. All representations, warranties and covenants contained in this Agreement, and the indemnification contained in this paragraph 5, shall survive the acceptance of this subscription.

6. No waiver. Notwithstanding any of the representations, warranties, acknowledgments or agreements made herein by the undersigned, the undersigned does not thereby or in any other manner waive any of the rights granted to him under federal or state securities laws.

7. Entire Agreement; Modification. This Agreement constitutes the entire agreement among the parties hereto

with respect to the subject matter hereof, and neither this Agreement nor any provisions hereof shall be waived, changed, discharged or terminated except by an instrument in writing signed by the party against whom any waiver, change, discharge or termination is sought.

8. Notices. Any notice, demand or other communication which any party hereto may be required, or may elect, to give to anyone interested hereunder shall be sufficiently given if (i) deposited, postage prepaid, in the United States mail, registered or certified mail, return receipt requested, addressed to: in the case of the Partnership: Sigma Inc., General Partner, Vol Partners, L.P., 101 Carnegie Center, Ste. 203 Princeton, NJ 08540, and in the case of the undersigned, at the address set forth on the signature page hereof or at such other address as the undersigned shall so notify pursuant hereto, or (ii) delivered personally at such address.

9. Binding Effect. Except as otherwise provided herein, this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective heirs, executors, administrators, successors, legal representatives and assigns. If the undersigned is more than one person, the obligations of the undersigned shall be joint and several and the agreements, representations, warranties and acknowledgments herein contained shall be deemed to be made by and be binding upon each such person and his respective heirs, executors, administrators, successors, legal representatives and assigns.

10. Assignability. The undersigned agrees not to transfer or assign this Agreement, or any of the undersigned's interest herein, and further agrees that the transfer or assignment of the Units shall be made only pursuant to the provisions of the Limited Partnership Agreement and in accordance with applicable laws.

11. Applicable Law. This Agreement shall be governed by and construed in accordance with the laws of the State of New Jersey.

12. Form of Ownership. Please indicate form of ownership desired.

Individual	_____
Joint tenants with right of survivorship	_____
Tenants in common	_____
Community property	_____
Corporation	_____
Partnership	_____
Trust	_____
Other (specify)	_____

13. Items to be Delivered by Subscriber.

(a) One completed and executed Subscription Agreement.

(b) One executed Power of Attorney.

day of_____, at _____(City), _____(State).

INDIVIDUAL(S) SIGN HERE

NOTE: All individuals with a direct beneficial interest in the Partnership as a joint tenant, tenant in common or otherwise must sign below, and execute the Power of Attorney (Exhibit B-1).

_____

Signature

_____

Social Security Number

_____

Printed Name

Residence Address:

_____

_____

_____

_____

Exhibit B-1

VOL PARTNERS, L.P.

POWER OF ATTORNEY

General Partner, VOL Partners L.P., 101 Carnegie Center, Ste 203 Princeton, N.J. 08540.

Dear Sir:

In connection with my interest in VOL PARTNERS, L.P. (the "Partnership") I do hereby irrevocably constitute and appoint Sigma Inc. (the "General Partner") as my true and lawful Attorney-in-Fact, with full power of substitution, in my name, place and stead, to execute, acknowledge and swear to (i) the Limited Partnership Agreement of the Partnership, and (ii) such Powers of Attorney and other account forms as shall be required by the Partnership's Clearing Firm and Bank.

The Power of Attorney granted herein shall be irrevocable and deemed to be a power coupled with an interest and shall survive the incapacity or death of a Partner. Each Partner agrees to be bound by representations made by the General Partner and by any successor thereto, acting in good faith pursuant to such Power of Attorney, and each Partner hereby waives any and all defenses which may be available to contest, negate or disaffirm

the action of the General Partners taken pursuant to this Power of Attorney.

_____

Individual Partner

_____

Entity Partner

_____

(Name of Entity)

_____

By
(Authorized trustee, partner or corporate officer)

Exhibit B-2

VOL PARTNERS, L.P.

REQUEST FOR REDEMPTION

General Partner, VOL Partners L.P., 101 Carnegie Center, Ste 203 Princeton, N.J. 08540.

Dear Sirs:

I hereby request redemption, as defined in and subject to all the terms and conditions of Vol Partners, L.P., (the "Partnership"), of $_____ of my limited partnership Interest of the Partnership. The redemption will be for _____ Units based on the Net Asset Value of a Unit as defined in the Limited Partnership Agreement, for each Unit indicated, less any amounts owed by me to the Partnership pursuant to Paragraph 9 of the Limited Partnership Agreement. Redemption shall be effective as of the first day of the next calendar quarter occurring 90 days (or such lesser period as may be acceptable to you) after receipt by you of this Request for Redemption. I hereby represent and warrant the I am the true, lawful and beneficial owner of the Units of limited partnership Interest of the Partnership to which this request relates with full power and authority to request redemption of such Units. Such Units are not subject to any pledge or otherwise encumbered in any fashion.

SIGNATURES MUST BE IDENTICAL TO NAME(S) IN WHICH UNITS OF LIMITED PARTNERSHIP ARE REGISTERED

Please forward such funds by mail to the undersigned at:

_____

Name

_____

Street

_____

City State and ZIP Code

_____

(Signature of limited partner)

_____

Requested Redemption Date

Supreme Court, U.S.
FILED
DEC - 7 2000
CLERK

(3)

No. 00-733

In the Supreme Court of the United States

RICHARD NICHOLAS, ET AL.,
PETITIONERS,

v.

SAUL STONE & COMPANY LLC, ET AL.,
RESPONDENTS.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STEPHEN P. BEDELL
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Chicago, Illinois 60610
(312) 644-3000

Attorneys for Respondents
Saul Stone & Company LLC,
First Options of Chicago, Inc.,
LFG, LLC and
ING (U.S.) Securities Futures & Options, Inc.

December 6, 2000

17 pp

Corporate Disclosure Statements as required by Rule 29.6

(1) Saul Stone & Company LLC is not a subsidiary or affiliate of any publicly owned corporation.

(2) First Options of Chicago, Inc. is a wholly owned subsidiary of SLK Acquisition Co., which is a wholly owned subsidiary of SLK Holdings Inc., which is a wholly owned subsidiary of The Goldman Sachs Group, Inc. The common stock of The Goldman Sachs Group, Inc. is listed on the New York Stock Exchange.

(3) LFG, LLC is not a subsidiary or affiliate of any publicly owned corporation.

(4) ING (U.S.) Securities Futures & Options, Inc. is an affiliate of ING Groep N.V., which is a publicly owned, Netherlands-based corporation. The common stock of ING Groep N.V. is listed on the New York Stock Exchange.

TABLE OF CONTENTS

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iii

OPINIONS BELOW 2

JURISDICTION 2

STATEMENT OF THE CASE 2

REASONS FOR DENYING THE PETITION 5

Summary of Argument 5

I. The Alleged "Conflicts" Cited By Petitioners Simply Do Not Exist 5

A. The Courts Below Did Not Ignore, And Their Decisions Do Not Conflict With, The Second Circuit's Peltz Decision 6

B. The Other Court Decisions Cited By Petitioners Are Entirely Consistent, Not In Conflict, With The Rejection Of Petitioners' Claims 7

C. There Is No Relevant "Conflict Among The Courts And Regulatory Bodies" 9

II. The Petitioners' Arguments Ignore The Lower Court's Findings That They Have Failed To Allege Sufficient Facts To State A Claim 11

CONCLUSION 12

TABLE OF AUTHORITIES

Cases:	Page
Acampora v. Prudential-Bache Securities Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,792 (C.F.T.C. Aug. 31, 1987)).	9
Acampora v. Prudential-Bache Securities Inc., CFTC No. 84-R486, 1988 WL 228951 (C.F.T.C. Oct. 7, 1988).	10
Birotte v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 468 F. Supp. 1172 (D.N.J. 1979)	8
In re Farmers Group Stock Options Litig., No. 88-4994, 1989 WL 73245 (E.D. Pa., July 5, 1989)	8
Indemnified Capital Invs., S.A. v. R.J. O'Brien & Assocs., Inc., 12 F.3d 1406, 1412 (7th Cir. 1993)	8
Inter-Asset Finanz AG v. Refco, Inc., No. 92 C 7833, 1993 WL 222710 (N.D. Ill., June 21, 1993)	8
In re Lake States Commodities, Inc., 936 F. Supp. 1461 (N.D. Ill. 1996)	7-8
Peltz v. SHB Commodities, Inc., 115 F.3d 1082 (2d Cir. 1997)	6-7
Spicer v. Chicago Bd. Options Exch., Inc., 977 F.2d 255 (7th Cir. 1992)	8
Unity House, Inc. v. First Commercial Financial Group, 1997 WL 701345 (N.D. Ill., Nov. 5, 1997), *aff'd*, 175 F.3d 1022 (7th Cir. 1999)	8

Rules of Self-Regulatory Organizations:

National Futures Association Bylaw 1101 ..... *passim*

Other Authorities:

Supreme Court Rule 10 5

No. 00-733

In the Supreme Court of the United States

RICHARD NICHOLAS, ET AL.,
PETITIONERS,

v.

SAUL STONE & COMPANY LLC, ET AL.,
RESPONDENTS.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents Saul Stone & Company LLC ("Saul Stone"), First Options of Chicago, Inc. ("First Options"), LFG, LLC ("LFG") and ING (U.S.) Securities, Futures & Options, Inc. ("ING") jointly submit this brief in opposition to the petition for writ of certiorari submitted by Petitioners Richard Nicholas, Lynn Nicholas, Robert M. Blackburn and Cheryl S. Blackburn (collectively, the "Petitioners"). Petitioners seek a writ of certiorari to review a portion of an opinion and order of the United States Court of Appeals for the Third Circuit, which affirmed the district court's dismissal with prejudice of Petitioners' entire Amended Complaint.

In particular, the Petitioners ask this Court to create an implied private cause of action under Bylaw 1101 of the National Futures Association ("NFA") against futures commission merchants and the NFA itself. NFA Bylaw 1101 does not create, and the Commodity Exchange Act does not provide for, any such private cause of action against futures commission merchants[1] and, particularly under the facts and procedural posture of this case, this Court should deny the Petition.

OPINIONS BELOW

Contrary to the statement in Petitioners' brief at 1, the August 7, 2000 opinion of the Third Circuit is reported at 224 F.3d 179 (3d Cir. 2000). The June 30, 1998 decision of the United States District Court for the District of New Jersey (Thompson, D.J.) (Pet. App. 31a-91a) is unpublished.

JURISDICTION

The Respondents agree with the Petitioners' jurisdictional statement. (Cert. Pet. at xi)

STATEMENT OF THE CASE

In the District Court, Petitioners filed a rambling, eleven-count, 63-page First Amended Class Action Complaint (the "Complaint"). The defendants included twelve separate, unrelated institutional clearing firms (the

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[1] Respondents understand that the issue of whether this Court should grant certiorari on the question of whether a private cause of action under NFA Bylaw 1101 may be maintained against the NFA will be separately addressed by the NFA. Accordingly, Respondents do not address that issue here.

"FCM Defendants"[2]), two individuals[3] and even the NFA, which is the association that regulates the futures industry. The central allegations of the Complaint, however, did not address the alleged conduct or actions of any of the defendants. Rather, the Complaint focused at length on the fraud perpetrated upon Petitioners and other investors by non-parties Sigma, Inc., Chuckles Kohli ("Kohli") and N.S. Ramchandran ("Ramchandran").

Chief Judge Anne Thompson, who presided over the Petitioners' case below, also heard separate criminal and civil proceedings against Kohli, Ramchandran and/or Sigma, Inc. (see Pet. App. at 40a):

- *United States v. Kohli*, No. 96-132 (AET) (D.N.J). Kohli pleaded guilty to five counts of federal criminal charges in connection with his commodity futures activities and was sentenced to 75 months' imprisonment on July 17, 1996.

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2 Respondents Saul Stone, First Options, LFG, ING, Smith Barney, Inc., Dean Witter Reynolds, Inc., Prudential Securities Incorporated, Rosenthal Collins Group, L.P., E.D. & F Man International, Inc. and Merrill Lynch, Pierce, Fenner & Smith, Inc. are collectively referred to herein as the "FCM Defendants". The FCM Defendants are registered futures commission merchants and members of the NFA.

3 Petitioners' claims against the individually named defendants, Clarence Delbridge and Thomas Stone, were dismissed for lack of jurisdiction by the district court. The Third Circuit Court of Appeals affirmed that dismissal. The Petitioners do not include these individual defendants as parties before this Court. (Cert. Pet. at ii, 8 n.3)

- *Commodity Futures Trading Commission v. Sigma, Inc., Chuck Kohli and N.S. Ramchandran*, Civil Action No. 95-1598 (AET) (D.N.J.). In this action, Judge Thompson appointed a Permanent Equity Receiver for Sigma, Inc. and other related entities. According to the District Court records, on March 29, 1999, Consent Orders for Permanent Injunctions were entered against Defendants Kohli and Ramchandran. In addition, the Consent Order required Kohli to pay the Permanent Equity Receiver $30,000,000.

The Petitioners' Complaint failed to include a specific count for an implied private cause of action under Bylaw 1101 of the National Futures Association ("NFA") against the FCM Defendants. Instead, Petitioners attempted to state claims against the FCM Defendants for violation of the Commodity Exchange Act (Count I), breach of contract (Count II), violation of the New Jersey Uniform Securities Law (Count IV), breach of fiduciary duty (Count VII), negligence (Count VIII), RICO violations (Count IX), fraud and civil conspiracy (Count X) and violation of the New Jersey Consumer Fraud Act (Count XI).[4] Chief Judge Anne Thompson held that none of these eight counts stated a cause of action against the FCM Defendants (or any other defendant).

With respect to the FCM Defendants, the Petitioners appealed only the dismissal of their claims for violation of the Commodity Exchange Act (Count I), breach of contract

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[4] Count III, which purported to state a claim for "bad faith failure to enforce NFA rules", was directed at the NFA. Petitioners omitted Counts V and VI of their original complaint from the Amended Complaint.

(Count II), breach of fiduciary duty (Count VII), negligence (Count VIII) and violation of the New Jersey Consumer Fraud Act (Count XI). The Circuit Court of Appeals for the Third Circuit affirmed the District Court's dismissal of these claims. The Third Circuit explained in detail its rejection of the Petitioners' claims under the Commodity Exchange Act (Pet. App. at 18a-29a) and simply adopted the district court's "cogent and persuasive" reasoning with respect to the remainder of the Petitioners' challenges. (Pet. App. at 29a)

Now, the Petitioners stray from the focus of the arguments they made below and ask this Court to recognize a separate, private right of action for violation of NFA Bylaw 1101. In this effort, however, the Petitioners utterly fail to justify why this Court should grant the requested writ.

REASONS FOR DENYING THE PETITION

Summary Of Argument

Petitioners make no valid effort to meet the standards for a grant of certiorari. Instead, they attempt to conjure up non-existent "conflicts" and simply reargue the alleged merits of their dismissed claims in the context of NFA Bylaw 1101. The petition's disjointed arguments do not provide the "compelling reasons" (Sup. Ct. R. 10) necessary to justify the exercise of this Court's discretion to grant review, and the petition should be denied.

I. The Alleged "Conflicts" Cited By Petitioners Simply Do Not Exist.

The Petitioners' go through analytical contortions to contrive purported "conflicts" which might convince this

Court to grant certiorari. Unfortunately, their strained attempts to divine "conflicts among the judiciary, regulatory bodies, legislative intent and association rule enforcement" (Cert. Pet. at 11) amount to no more than the Petitioners' disagreement with a consistent statutory and regulatory regime applied by the NFA and the courts.

A. The Courts Below Did Not Ignore, And Their Decisions Do Not Conflict With, The Second Circuit's *Peltz* Decision.

Petitioners assert that the Third Circuit and District Court below ignored the Second Circuit's decision in *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082 (2d Cir. 1997). Petitioners, however, do not provide in their petition – and did not provide in their briefs below – any discussion of the facts or context of *Peltz* or even a specific page citation to the portion of that decision deemed most relevant by the Petitioners. Instead, they cite *Peltz* simply for a general "headnote" proposition:

> Generally, before accepting trades from a third party, the FCM must make a reasonable inquiry into the nature and extent of the individual's authority. *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082 (2d Cir. 1997).

(Cert. Pet. at 13) See *Peltz*, 115 F.3d at 1088. As Petitioners' own reference suggests, *Peltz* dealt with a future commission merchant's obligations when receiving trade orders from a disclosed third party (Mr. Weingarten), who was trading for the account of a customer (Mr. Peltz). *Peltz*, 115 F.3d at 1085-86. Unlike *Peltz*, the present case involves a "Ponzi scheme designed and executed by Charles Kohli . . .,

Ram Chandran . . . and through various commodity pools collectively known as . . . the 'Sigma Entities' ". (Cert. Pet. at 7) There is no allegation that Messrs. Kohli and Ramchandran and Sigma traded accounts in the Petitioners' names as the Petitioners' disclosed agents.

Perhaps more significant than the absence of any relevant factual parallel between *Peltz* and the present case is the absence of any reference in *Peltz* to NFA Bylaw 1101, the regulatory provision at the core of Petitioners' present arguments. Under these circumstances, the *Peltz* decision could have provided little insight to the courts below in connection with their consideration of NFA Bylaw 1101. Accordingly, Petitioners' attempt to impugn the Third Circuit and District Court for "ignor[ing] *Peltz*" rings particularly hollow. Certainly, given the factual and legal disparities between the matters before the courts below and the matters decided in *Peltz*, Petitioners' assertion that the decisions below are in conflict with *Peltz* is simply nonsensical.

B. The Other Court Decisions Cited By Petitioners Are Entirely Consistent, Not In Conflict, With The Rejection Of Petitioners' Claims.

Having mischaracterized the holding in *Peltz*, Petitioners then point to a number of cases that purportedly conflict with *Peltz* (as misconstrued by Petitioners) and attempt to minimize or mischaracterize the holdings in those cases that no private right of action exists under NFA Bylaw 1101 or similar provisions. (Cert. Pet. at 13-15) One of the cases, *In re Lake States Commodities, Inc.*, 936 F. Supp. 1461, 1469 (N.D. Ill. 1996), specifically "decline[d] to imply a private cause of action into Bylaw 1101 and its Interpretive Notice." The *Lake States* court correctly relied upon two

other cases, also cited by Petitioners, recognizing that "the Seventh Circuit has previously rejected the proposition that general rules of an exchange organization can be construed to create private rights of action." (emphasis added) *Lake States*, 936 F. Supp. at 1469, citing *Indemnified Capital Invs., S.A. v. R.J. O'Brien & Assocs., Inc.*, 12 F.3d 1406, 1412 (7th Cir. 1993) (affirming the dismissal of a breach of fiduciary duty claim based on NFA Compliance Rule 2-4) and *Spicer v. Chicago Bd. Options Exch., Inc.*, 977 F.2d 255, 265 (7th Cir. 1992) (refusing to imply a private cause of action for violations of rules of the Chicago Board Options Exchange).

These holdings are consistent with many other decisions rejecting attempts to imply private rights of action pursuant to CFTC regulations or exchange rules. See, *e.g.*, *Unity House, Inc. v. First Commercial Financial Group*, 1997 WL 701345, at *4 (N.D. Ill., Nov. 5, 1997) ("the CFTC and NFA rules do not provide causes of action"), *aff'd*, 175 F.3d 1022 (7th Cir. 1999); *Inter-Asset Finanz AG v. Refco, Inc.*, No. 92 C 7833, 1993 WL 222710, at *4 (N.D. Ill., June 21, 1993) (granting summary judgment for defendant futures commission merchant on claims based upon purported violations of Chicago Mercantile Exchange rules, because "there is no private cause of action for exchange rule violations"); *In re Farmers Group Stock Options Litig.*, No. 88-4994, 1989 WL 73245, at *3 (E.D. Pa., July 5, 1989) ("Courts in this circuit have unanimously refused to recognize any private right of action for violation of a stock exchange rule"); *Birotte v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 468 F. Supp. 1172, 1180, 1184-85 (D.N.J. 1979) (holding that no implied federal right of action exists for alleged violations of Exchange rules).

As these numerous cases make clear, the decisions of the courts below were not in conflict with other courts to the extent they rejected an implied private right of action based upon NFA Bylaw 1101. Indeed, a long line of well-established authority supports the rejection of any such implied private right of action.

C. There Is No Relevant "Conflict Among The Courts And Regulatory Bodies".

Petitioners also suggest that some ill-defined conflict exists "among the courts and regulatory bodies" (Cert. Pet. at 15) with respect to the existence of an implied private right of action under NFA Bylaw 1101. This suggestion appears to be based mainly on *dicta* in a 1987 decision of a CFTC administrative law judge ("ALJ"). (Cert. Pet. at 15, citing *Acampora v. Prudential-Bache Securities Inc.*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,792 (C.F.T.C. Aug. 31, 1987)).

In *Acampora*, the ALJ rejected the complainant's claims of breach of fiduciary duty and unauthorized trading. Having done so, the ALJ noted the undisputed fact that the account executive responsible for complainant's account was not registered during the relevant time period due to an oversight by respondents. The ALJ then commented in *dicta* that "[f]ailure on the part of associated persons to be registered . . . may render them liable for any damages resulting from trading activities during the time they are not registered." (emphasis added) The mere suggestion by an ALJ – in *dicta* – that an unregistered associated person "may" be liable for certain damages hardly creates a conflict with respect to the lower court's rejection of an implied private right of action

against futures commission merchants for an alleged violation of NFA Bylaw 1101.

The absence of any meaningful conflict is further highlighted by the CFTC's summary affirmance of the ALJ's decision in *Acampora*, wherein the CFTC expressly limited the precedential value of the ALJ's decision:

> Upon consideration of the briefs and the record as a whole, we are satisfied that the initial decision is substantially correct in result, and that no important question of law or policy has been raised on appeal. Accordingly, we have determined that the initial decision should be affirmed without opinion.
>
> In making this determination, we do not adopt the initial decision including any rationale contained therein, as our own, and neither the initial decision nor our order of summary affirmance shall serve as Commission precedent in other proceedings. See 17 C.F.R. § 12.406(b) (1984). (emphasis added)

Acampora v. Prudential-Bache Securities Inc., CFTC No. 84-R486, 1988 WL 228951 (C.F.T.C. Oct. 7, 1988). Insofar as the CFTC has determined that the ALJ's "initial decision . . . shall [not] serve as Commission precedent in other proceedings" (*id.*), it certainly should not be considered to establish a conflict among the courts and the CFTC justifying Supreme Court review.

The Petitioners have failed to point to any legitimate conflict between the decision of the Third Circuit in this

matter and any other court of appeals or the highest court of any state. Nor have the Petitioners established any other basis for this Court to grant their petition. Accordingly, the Petition should be denied.

II. The Petitioners' Arguments Ignore The Lower Court's Findings That They Have Failed To Allege Sufficient Facts To State A Claim.

In the petition, as they have throughout this litigation, Petitioners fail to focus on the critical deficiency in their Complaint. As the District Court and the Third Circuit concluded, the Petitioners have failed to allege facts sufficient to state any cause of action against the FCM Defendants. In particular, the courts below have found that

- "[T]here are no allegations that defendants had any contact with [Petitioners] to solicit business or provide advice. Considering the absolute absence of a relationship between [Petitioners] and defendants, this Court cannot find that defendants' actions created an unreasonable risk of harm to [Petitioners] or that the injury to [Petitioners] was foreseeable in the instant case." (Pet. App. 78a)

- "[T]he lack of relationship between the [Petitioners] and [the FCM Defendants] forecloses the possibility that a fiduciary duty existed between them." (Pet. App. at 75a)

- The FCM Defendants are not alleged to have acted with any intent to further the violations of the CEA by Messrs. Kohli and Ramchandran and Sigma. (Pet. App. 29a)

Thus, whatever theory Petitioners have pursued or hope to pursue, the facts remain that (a) their relationships were with the wrongdoers, Messrs. Kohli and Ramchandran and Sigma, not with the FCM Defendants; (b) the FCM Defendants did not owe a duty to the Petitioners, did not create an unreasonable risk of harm to the Petitioners and could not foresee a risk of harm to the Petitioners and (c) the FCM Defendants did not act with any intent to further the wrongdoing of Messrs. Kohli and Ramchandran and Sigma. These facts must be fatal to any claims by the Petitioners against the FCM Defendants.

CONCLUSION

For all the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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No. 00-733

In the

Supreme Court of the United States

RICHARD NICHOLAS, et al.,

Petitioners,

v.

SAUL STONE & COMPANY, LLC, et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF IN OPPOSITION FOR RESPONDENT NATIONAL FUTURES ASSOCIATION

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QUESTIONS PRESENTED

1. Should the federal courts create an implied private right of action under the Commodities Exchange Act ("CEA") against NFA Members for damages resulting from violations of NFA Bylaw 1101 despite the fact that no such action is contained in the exclusive remedies available to investors that were expressly created by Congress?

2. CEA § 22(b)(2) provides plaintiffs with an express cause of action against the NFA for failing to enforce any bylaw that is "required" by CEA § 17. NFA Bylaw 1101 was promulgated under § 17(m), which provides that the CFTC "may" approve certain membership rules of futures associations. Did the district court and the Third Circuit correctly determine that Bylaw 1101 was not "required" by § 17(m), and that the NFA therefore cannot be liable under § 22(b)(2) for allegedly failing to enforce that bylaw?

RULE 29.6 STATEMENT

Respondent National Futures Association is a not-for-profit corporation that operates as a registered futures association under 7 U.S.C. § 17. It has no parent corporation and no capital stock. Therefore, no publicly-held company owns 10% or more of the NFA's stock.

TABLE OF CONTENTS

PAGE

QUESTIONS PRESENTED i

RULE 29.6 STATEMENT ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES v

STATEMENT OF THE CASE 1

The History Of NFA Bylaw 1101 1

The Express Right Of Action In § 22 Of The Commodities Exchange Act 3

The Decisions Of The District Court And Third Circuit 5

REASONS FOR DENYING THE PETITION 6

I. THE ONLY ARGUMENT DIRECTED AGAINST THE NFA THAT PROPERLY HAS BEEN PRESENTED TO THIS COURT IS WHETHER NFA BYLAW 1101 CAN FORM THE BASIS FOR A PRIVATE ACTION UNDER CEA § 22(b)(2) 8

II. THE COURT SHOULD DENY REVIEW OF PETITIONERS' CLAIM THAT THE NFA CAN BE HELD LIABLE UNDER CEA § 22(b)(2) FOR NOT ENFORCING BYLAW 1101 10

A. No Conflict Exists Between The Decision Of The Third Circuit In This Case And Any Other Court Regarding Petitioners' Sole Claim Against The NFA 10

B. The Third Circuit's Decision Is Fully Consonant With Prior Decisions Of This Court And The Plain Language And Legislative History Of The CEA 11

III. THE COURT SHOULD DECLINE PETITIONERS' INVITATION TO DECIDE WHETHER NFA BYLAW 1101 PROVIDES AN IMPLIED PRIVATE RIGHT OF ACTION AGAINST THE NFA'S MEMBERS 16

A. No Conflict Exists For This Court To Resolve 16

B. The NFA Has Never Endorsed Or Condoned A Private Right Of Action To Enforce Bylaw 1101 18

C. This Court Should Not Entertain Petitioners' Request For A New Implied Private Right Of Action 19

CONCLUSION 22

TABLE OF AUTHORITIES

Cases	PAGE(S)
Acampora v. Prudential Bache Securities, Inc., [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,792 (C.F.T.C. Aug. 31, 1987)	17
American Agriculture Movement, Inc. v. Board of Trade, 977 F.2d 1147 (7th Cir. 1992)	21
Board of Trade v. Securities & Exchange Commission, 883 F.2d 525 (7th Cir. 1989)	9, 10
Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 410 F.2d 135 (7th Cir. 1969)	19, 21-22
Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164 (1994)	20
Colonial Realty Corp. v. Bache & Co., 358 F.2d 178 (2d Cir. 1966)	21
Fogerty v. Fantasy, Inc., 510 U.S. 517 (1994)	13
Franklin v. Gwinnett County Public Schools, 503 U.S. 60 (1992)	20
Gebser v. Lago Vista Independent School District, 524 U.S. 274 (1998)	20
Harvey v. Board of Chosen Freeholders, 153 A.2d 10 (N.J. 1959)	15

Heckler v. Chaney, 470 U.S. 821 (1985) 9, 18-19

Idahoan Fresh v. Advantage Produce, Inc.,
157 F.3d 197 (3d Cir. 1998) 13

Indemnified Capital Investments, S.A.
v. R.J. O'Brien & Associates, Inc.,
12 F.3d 1406 (7th Cir. 1993) 22

Izumi Seimitsu Kogyo Kabushiki Kaisha v.
U.S. Philips Corp., 510 U.S. 27 (1993) 9

In re Lake States Commodities, Inc.,
936 F. Supp. 1461 (N.D. Ill. 1996) 16

Lang v. French, 974 F. Supp. 567
(E.D. La. 1997) 10

Merrill Lynch, Pierce, Fenner & Smith,
Inc. v. Curran, 456 U.S. 353 (1982) 3, 4, 19

Musick, Peeler & Garrett v. Employers
Insurance, 508 U.S. 286 (1993) 20

Nelson v. Adams USA, Inc., 529 U.S. 460,
120 S. Ct. 1579 (2000) 8-9

Peltz v. SHB Commodities, Inc., 115 F.3d
1082 (2d Cir. 1997) 16, 17

Porter v. Shearson Lehman Brothers, Inc.,
802 F. Supp. 41 (S.D. Tex. 1992) 21

Shultz v. Securities & Exchange Commission, 614 F.2d 561 (7th Cir. 1980) 10

Smith v. United States, 508 U.S. 223 (1993) 13

Spicer v. Chicago Board of Options Exchange, Inc., 977 F.2d 255 (7th Cir. 1992) 22

Thompson v. Thompson, 484 U.S. 174 (1988) 20

Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) 20, 21

Statutes and Rules

7 U.S.C. § 18 (CEA § 14) 17

7 U.S.C. § 21 (CEA § 17) ..... *passim*

7 U.S.C. § 25 (CEA § 22) ..... *passim*

5 U.S.C. § 551 9-10

SUP. CT. R. 10 ..... 6, 7, 11, 12

SUP. CT. R. 14 9

NFA Bylaw 1101 2-3

Other Authority

124 Cong. Rec. H7206 (daily ed. July 24, 1978) ... 2, 14

STATEMENT OF THE CASE

The History Of NFA Bylaw 1101

The National Futures Association ("NFA") is a private, not-for-profit membership corporation that operates as the futures industry's self-regulatory organization. (Pet. App. 38a.) The NFA has no capital stock, and no part of the NFA's net revenues or earnings may inure to the benefit of any Member. The NFA's revenues, therefore, consist almost entirely of membership dues and fees routinely assessed on its Members. (NFA 3d Cir. Br. at 6-7.)

On September 22, 1981, the Commodities Futures Trading Commission ("the CFTC") formally designated the NFA a "registered futures association" under Section 17 of the Commodity Exchange Act ("CEA"). (Pet. App. 120a.) This was not the NFA's first attempt to achieve that certification, however. The NFA previously had submitted a draft application in 1977, which included a mandatory membership requirement. (*Id.* at 95a.) The Justice Department expressed concern that this membership requirement was not "the least anticompetitive means available to the Commission to achieve the objectives of the Act," and that it therefore was unconstitutional and inconsistent with antitrust law. (*Id.* at 95a, 110a.) As a result, the CFTC placed the NFA's application on hold. (*Id.* at 96a.)

In 1978, Congress explicitly addressed the concerns raised by the Justice Department by amending the CEA to include a new § 17(m), which reads as follows:

> Notwithstanding any other provision of law, the Commission *may* approve rules of futures asso-

> ciations that, directly or indirectly, require persons eligible for membership in such associations to become members of at least one such association, upon a determination by the Commission that such rules are necessary or appropriate to achieve the purposes and objective of this chapter.

7 U.S.C. § 21(m) (emphasis added); (Pet. App. 173a); (*see also* Pet. App. 110a-113a.) In his remarks to Congress, Representative Foley clarified that this new section did not *require* a mandatory membership rule as a condition of certification as a registered futures association, but gave the CFTC the discretion to approve such a rule: "Use of the authority of this amendment would be completely discretionary with the Commission." 124 Cong. Rec. H7206 (daily ed. July 24, 1978); (Pet. App. 112a-113a.) This discretionary aspect of the rule was consistent with the Justice Department's warnings that requiring a mandatory membership rule would be unconstitutional and would violate antitrust laws.

After this Congressional amendment, the NFA submitted its official application to the CFTC for registration as a registered futures association on March 16, 1981. (Pet. App. 92a.) This application included NFA Bylaw 1101, which indirectly mandated NFA membership by futures industry professionals by prohibiting any NFA Member from doing business with non-Members. Bylaw 1101 states that:

> No Member may carry an account, accept an order or handle a transaction, in commodity futures contracts, for or on behalf of any non-Member of NFA, or suspended Member, that is

> required to be registered with the Commission [CFTC] as an FCM [Futures Contract Merchant], Introducing Broker, Commodity Pool Operator, Commodity Trading Advisor, or Leverage Transaction Merchant, and that is acting in respect to the account, order or transaction for a customer, a commodity pool or participant therein, a client of a commodity trading advisor, or any other person . . . . No Member may accept orders in commodity futures contracts to cover leverage transactions, for or on behalf of any non-Member of NFA, or suspended Member, that is required to be registered with the Commission as a Leverage Transaction Merchant . . . .

(Pet. App. 145a.)

In an order September 22, 1981, the CFTC granted the NFA's application. The CFTC relied on Congress' passage of CEA § 17(m) to conclude that, "there is no longer any question that the Commission *may*, in registering a futures association, entertain and approve a proposal that would, in effect, mandate membership in the association." (Pet. App. 113a (emphasis added).)

The Express Right Of Action In § 22 Of The Commodities Exchange Act

In 1982, this Court found an implied private right of action for violations of the anti-fraud provisions of the CEA. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 388 (1982). In reaching this result, the Court looked at the legal landscape at the time that the 1974 amendments to the CEA were enacted, and

determined that, in amending the CEA, Congress had not intended to change the preexisting remedy of private lawsuits against Futures Contract Merchants ("FCMs") and futures exchanges. *Id.* at 387-88. Congress responded to the *Curran* decision by again amending the CEA. In 1982, Congress enacted § 22, which provided an express cause of action in certain limited circumstances against FCMs, exchanges and registered futures associations. 7 U.S.C. § 25. Congress also made clear that the express causes of action in § 22 were the "exclusive" remedies provided by the CEA. 7 U.S.C. §§ 25(a)(2) & (b)(5).

Under Section 22(b)(2), a registered futures association can be sued only in the narrow circumstance where it fails to enforce a bylaw or rule that is *required* by § 17 of the Act:

> A registered futures association that fails to enforce any bylaw or rule that is *required* under section 21 [CEA § 17] of this title . . . shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce . . . such bylaw or rule.

7 U.S.C. § 25(b)(2) (emphasis added); (Pet. App. 179a.) Section 22(b)(4) provides that the association can only be liable if it "acted in bad faith in failing to take action." 7 U.S.C. § 25(b)(4); (Pet. App. 180a.)

Section 22(b)(5) provides that the right of action authorized by § 22(b)(2) is the "exclusive remedy" available to

any person who sustains such a loss. 7 U.S.C. § 25(b)(5); (Pet. App. 180a.). The limited remedies set forth in CEA § 22 thus wholly replaced the implied private rights of action that this Court previously recognized in *Curran*.

The Decisions Of The District Court And Third Circuit

Petitioners asserted in the district court that the NFA should be held liable under CEA § 22(b)(2) for not strictly enforcing NFA Bylaw 1101. The district court dismissed Petitioners' claim on the basis that Bylaw 1101 was not a "required" rule under CEA § 22(b)(2). (Pet. App. 68a-69a.) The district court followed the plain language of § 22(b)(2) that the NFA "must fail to enforce a bylaw, rule or regulation that is required to be enforced by Section 17 of the CEA" before it can be held liable. (*Id.* at 68a.) The court then found that "the plain meaning of the word 'may' in Section 17(m)" did not require adoption of Bylaw 1101, but only permitted it. (*Id.* at 69a.) After reviewing the plain language of the exclusive remedy contained in the CEA, the district court also determined, based on the only other district court decision on point, that no other private right of action could be judicially implied for violations of NFA Bylaw 1101. (*Id.* at 69a-70a.)

On appeal, the Third Circuit expressly adopted the conclusions reached by the district court, and found the district court's disposition of the issues against the NFA to be "cogent and persuasive." (Pet. App. 30a.)

REASONS FOR DENYING THE PETITION

The *certiorari* petition raises two issues, both of which revolve around NFA Bylaw 1101. The first issue is whether federal courts should create an implied right of action against NFA Members for violations of Bylaw 1101. The second is whether NFA Bylaw 1101 is "required" by § 17 of the Commodities Exchange Act so as to allow an express cause of action against the NFA under CEA § 22(b)(2) for an alleged bad faith failure to enforce the bylaw. Although only the second of these issues directly implicates a claim against the NFA itself, as opposed to its Members, for the sake of clarity and completeness, the NFA addresses both issues in this opposition brief.

This case fits none of this Court's criteria for the granting of *certiorari*. *See* SUP. CT. R. 10. As to the first issue—whether an implied private right of action exists for violations of Bylaw 1101—Petitioners have invented a conflict with the Second Circuit by citing a case that neither mentions Bylaw 1101 nor involves any implied private right of action at all. The only cases on point are those of the district court and court of appeals below and one case from the Northern District of Illinois, all of which are in agreement that no implied right of action exists for violations of Bylaw 1101. As to the second issue—the one brought against the NFA directly—the district court and court of appeals below are the only courts ever to have addressed this point. Petitioners do not attempt to argue otherwise. There is thus no "conflict with the decision of another United States court of appeals on the same important matter," or "with a de-

cision by a state court of last resort," or "with relevant decisions of this Court." *Id.*

Petitioners also can make no persuasive claim that the issues decided by the district court and Third Circuit in this case are ones that necessarily should be "settled by this Court." SUP. CT. R. 10(c). Because the statute under which Petitioners are proceeding already contains exclusive remedies that Petitioners have failed to meet, 7 U.S.C. § 25(b)(5); (Pet. App. 180a), this case is a particularly good example of why recent attempts to imply private rights of action inevitably have met with failure.

The second issue likewise was decided under well-settled principles of statutory construction. Section 22(b)(2) of the Commodities Exchange Act allows private causes of action against the NFA only where the NFA fails to enforce a bylaw or rule that is *required* by § 17 of the CEA. NFA Bylaw 1101 was promulgated under CEA § 17(m), which provides that the CFTC *may* approve the passage of such a bylaw. Both the plain language and legislative history of § 17(m) demonstrate conclusively that the word "may" was meant to make the passage of a mandatory membership rule discretionary and not a condition of approval as a registered futures association. The district court and court of appeals thus correctly found that § 17(m) did not "require" the passage of Bylaw 1101, and could not form the basis for a cause of action under CEA § 22(b)(2).

I. THE ONLY ARGUMENT DIRECTED AGAINST THE NFA THAT PROPERLY HAS BEEN PRESENTED TO THIS COURT IS WHETHER NFA BYLAW 1101 CAN FORM THE BASIS FOR A PRIVATE ACTION UNDER CEA § 22(b)(2).

The *certiorari* petition presents two questions to this Court. (Pet. at i.) Only the second of these questions involves a claim directed toward the NFA.

The first question asks only whether a private cause of action exists against *NFA Members*, not against the NFA itself: "Do investors in commodities futures contracts have a private cause of action against *NFA Members* for damages resulting from violations of NFA Bylaw 1101." (Pet. at i (emphasis added).)

In addition to the plain language of Petitioners' *certiorari* petition, Petitioners have expressly waived any such claim against the NFA. In its Reply Brief to the Third Circuit, Petitioners stated, "The NFA leads the Court to believe . . . that the Plaintiff's claim is essentially a private right of action outside of 7 U.S.C. § 25(b) [CEA § 22(b)]. This is simply not so." (Pet'r 3d Cir. Reply Br. at 15.) Immediately following this sentence is footnote 5, which provides, "Private right of action is being pursued as to the FCM Defendants." (*Id.* at 15 n.5.) Petitioners therefore have clarified that they are not seeking to impose an implied private right of action against the NFA itself. Indeed, nowhere in Petitioners' briefs below did they even attempt to make such an argument against the NFA; it is therefore waived. *See Nelson v. Adams USA, Inc.*, 529 U.S. 460, 120 S. Ct. 1579, 1586 (2000) ("It is indeed the general rule that issues must be raised in lower courts in order to be preserved as potential

grounds of decision in higher courts."). In sum, neither the first question presented nor Argument I in the *certiorari* petition, (Pet. at i, 11-22), involves claims directed at the NFA.[1]

Petitioners' Argument III, which raises issues under the Administrative Procedure Act, is entirely barred from this Court's review. (Pet. at 25-28.) Neither of the two questions presented by the petition reference the Administrative Procedure Act. Petitioners therefore have failed to comply with this Court's Rule 14.1(a). Merely discussing the issue in the text of the petition is not sufficient to bring it before the Court. *See Izumi Seimitsu Kogyo Kabushiki Kaisha v. U.S. Philips Corp.*, 510 U.S. 27, 31 n.5 (1993). Petitioners also never once raised this argument in the lower courts; thus, it is waived here. *Nelson*, 120 S. Ct. at 1586.[2]

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[1] Despite this issue not being raised against the NFA, the NFA nonetheless believes that this is not a question that should be considered by this Court on *certiorari* review. (*See* Section III *infra*.) Indeed, Petitioners thought so little of this argument that their lower court briefs barely mentioned it and the district court addressed it only in passing. (Pet. App. 69a-70a.)

[2] Argument III is a futile attempt to distinguish the solid body of case law from this Court and the federal circuits holding that an agency's decision not to enforce its own rules is presumed to be judicially unreviewable. *See, e.g., Heckler v. Chaney*, 470 U.S. 821, 830-32 (1985); *Bd. of Trade v. Sec. & Exch. Comm'n*, 883 F.2d 525, 530 (7th Cir. 1989). Furthermore, the NFA, as a self-regulatory body, is not a federal agency subject to the APA. *See* 5 U.S.C. § 551(1) (defining an "agency" as an "authority of the Government of the United

(continued...)

The only remaining claim against the NFA in the petition is the second question presented and the accompanying Argument II, namely, whether NFA Bylaw 1101 is "required" by CEA § 17 so as to allow a private right of action against the NFA under § 22(b)(2) if it, in bad faith, fails to enforce this bylaw. (Pet. at i, 22-25.) It is to this issue that we now turn.

II. THE COURT SHOULD DENY REVIEW OF PETITIONERS' CLAIM THAT THE NFA CAN BE HELD LIABLE UNDER CEA § 22(b)(2) FOR NOT ENFORCING BYLAW 1101.

A. No Conflict Exists Between The Decision Of The Third Circuit In This Case And Any Other Court Regarding Petitioners' Sole Claim Against The NFA.

The only courts ever to have ruled on the second issue presented to this Court—whether NFA Bylaw 1101 is required by CEA § 17 so as to trigger a private right of

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(...continued)
States"); *Shultz v. Sec. & Exch. Comm'n*, 614 F.2d 561, 569 (7th Cir. 1980) (Chicago Board Options Exchange was not an "authority of the Government of the United States" and thus was not subject to the APA); *Lang v. French*, 974 F. Supp. 567, 569 (E.D. La. 1997) ("SROs [self-regulatory organizations] are private organizations that operate subject to a scheme of government regulation. They generally are not subject to the requirement applicable to a government agency.") (citations omitted). Nevertheless, the rationale of these APA cases—that judges should not decide where an agency places its resources and priorities, *Board of Trade*, 883 F.2d at 531—applies by analogy to the NFA's role as a self-regulatory body.

action under § 22(b)—are the district court and court of appeals in this case. No other federal circuit court, federal district court or state court at any level has addressed this issue.

This case therefore fails to meet any of the criteria set forth in Supreme Court Rules 10(a) or 10(b) for granting a petition for a writ of *certiorari*. No "United States court of appeals has entered a decision in conflict with the decision of another United States court of appeals on the same important matter." SUP. CT. R. 10(a). The Third Circuit has not "decided an important federal question in a way that conflicts with a decision by a state court of last resort." *Id.* Nor has the Third Circuit's decision "so far departed from the accepted and usual course of judicial proceedings, or sanctioned such a departure by a lower court, as to call for an exercise of this Court's supervisory power." *Id.* Finally, no "state court of last resort has decided an important federal question" in this case. SUP. CT. R. 10(b). Indeed, no state court was involved here at all.

The only remaining basis for granting review on this issue can be found in Supreme Court Rule 10(c). That rule is addressed in the next section.

B. The Third Circuit's Decision Is Fully Consonant With Prior Decisions Of This Court And The Plain Language And Legislative History Of The CEA.

Supreme Court Rule 10(c) allows a discretionary grant of *certiorari* in those compelling circumstances where "a United States court of appeals has decided an important

question of federal law that has not been, but should be, settled by this Court, or has decided an important federal question in a way that conflicts with relevant decisions of this Court." SUP. CT. R. 10(c). The Third Circuit's adoption of the district court's holding here not only fails to conflict with any past decision of this Court, it is amply supported by the plain language and legislative history of the CEA and NFA Bylaw 1101.

Petitioners admit that, "In order for the NFA to be held liable pursuant to 7 U.S.C. § 25(b)(2) [CEA § 22(b)(2)] . . . it must have failed to enforce a bylaw or rule *required* by 7 U.S.C. § 21 [CEA § 17]." (Pet. at 22 (emphasis added).) NFA Bylaw 1101, which prohibits transactions with non-Members, is not a bylaw *required* by Section 17 of the CEA. The NFA adopted this bylaw pursuant to CEA § 17(m), which provides that, "the Commission *may* approve rules of futures associations that, directly or indirectly, require persons eligible for membership in such associations to become members of at least one such association . . . ." 7 U.S.C. § 21(m) (emphasis added); (Pet. App. 173a.).[3]

The district court and court of appeals correctly determined that the plain meaning of the word "may" in § 17(m) *permits* the NFA to adopt rules such as Bylaw 1101, but does not *require* the NFA to do so as a condi-

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[3] Petitioners also make passing reference to CEA § 17(b)(8) [7 U.S.C. § 21(b)(8)], which requires that the rules of the association provide for appropriate discipline of its members. (Pet. App. 160a.) That section is irrelevant, however, because NFA Bylaw 1101 was passed under CEA § 17(m), not § 17(b)(8). (Pet. App. 109a-115a.)

tion to becoming a registered futures association. "The word 'may' clearly connotes discretion." *Fogerty v. Fantasy, Inc.*, 510 U.S. 517, 533 (1994). Where, as in this case, the "ordinary and natural meaning" of Congressional language is absolutely unambiguous, that language cannot be disregarded. *Smith v. United States*, 508 U.S. 223, 228 (1993).

To avoid this result, Petitioners are relegated to arguing that, "As used in 7 U.S.C. § 21(m) [CEA § 17(m)] . . . MAY means SHALL and is mandatory." (Pet. at 23 (emphasis in original).) While a court may depart from the plain language of a statute by an extraordinary showing of contrary congressional intent, *Idahoan Fresh v. Advantage Produce, Inc.*, 157 F.3d 197, 202 (3d Cir. 1998), the legislative history of § 17(m) clearly demonstrates that Congress meant what it said here.

Congress amended the CEA in 1978 to include Section 17(m), partially in response to the Justice Department's concerns that the NFA's proposed Bylaw 1101 was *prohibited* by the Fifth Amendment and antitrust law. (Pet. App. 110a.) In keeping with the Department of Justice warnings, Congress drafted Section 17(m) in such a way as to affirmatively reject any requirement that a registered futures association mandate membership as a condition to its registration. (*Id.* at 112a.) To the contrary, "Congress expressly authorized the Commission, *in its discretion*, to approve requirements that directly or indirectly mandate membership in futures associations . . . ." (*Id.* (emphasis added).) So as to remove any doubt about Congress' intentions, Representative Foley, when introducing § 17(m), made clear that this new section contains no mandatory membership requirement:

> [Section 17(m)] provides expressly that the Commission *may* approve rules for any futures association or associations that would require persons eligible for membership to become members of at least one such association . . . . Use of the authority of this amendment would be *completely discretionary* with the Commission.

(Pet. App. 112a-113a (emphasis added)); 124 Cong. Rec. H7206 (daily ed. July 24, 1978). The CFTC exercised that discretion in 1981 when it approved the NFA's application to become a registered futures association. (Pet. App. 109a-115a, 120a.) Both the plain meaning and legislative history of § 17(m) thus demonstrate that it is not a "required" rule for purposes of § 22(b)(2).[4]

Petitioner's argument that § 17(m) makes NFA Bylaw 1101 a "required" rule simply because it is in the "public interest" is specious. Petitioners cite only to a case from the New Jersey Supreme Court, which notes that, "the word 'may' must be given 'a mandatory significance where it is employed in a statute to delegate a power, the exercise of which is important for the protection of public interests *and where, it can clearly be taken from the nature and object of the statute, a mandatory significance*

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[4] At various times in their Petition, Petitioners appear to confuse the mandatory nature of Bylaw 1101 itself (which requires membership in the NFA to transact business) with the question of whether such a bylaw is required by CEA § 17 as a condition to being approved as a registered futures association. Under CEA § 22(b)(2), however, the only relevant question is whether the bylaw is "required under section 21 of this title [CEA § 17]," *not* whether the bylaw itself imposes mandatory requirements upon NFA Members.

was intended.'" Harvey v. Bd. of Chosen Freeholders, 153 A.2d 10, 16 (N.J. 1959) (citation omitted, emphasis added). At issue in *Harvey* was a New Jersey statute that provided, "The board of chosen freeholders . . . May retire any court attendant in the office of sheriff" upon reaching 65 years of age. *Id.* at 13. The court determined that the legislature meant for the statute to be mandatory, relying mainly on the "statement of purpose" attached to the statute, which clearly provided: "This bill will *Require* pensionable court attendants . . . to retire at 65 . . . ." *Id.* at 16-17 (emphasis added). Of course, no similar statement of purpose can be found in § 17(m). On the contrary, the clear legislative purpose of § 17(m) was to render the passage of membership requirements like Bylaw 1101 discretionary in order to avoid constitutional and antitrust problems. (Pet. App. 110a-113a.)

In sum, the legislative intent, history, structure and plain language of § 17(m) demonstrate that, although rules such as Bylaw 1101 *may* be adopted by a registered futures association, they are not "required" by § 17. Because Petitioners' claim under § 22(b)(2) was based on the NFA's alleged failure to enforce NFA Bylaw 1101—a rule not required by CEA § 17—it properly was dismissed. The ruling below was consonant with well-settled principles of statutory construction and does not conflict with any past decisions of this Court or of any other court. It is therefore simply not worthy of *certiorari* review.

III. THE COURT SHOULD DECLINE PETITIONERS' INVITATION TO DECIDE WHETHER NFA BYLAW 1101 PROVIDES AN IMPLIED PRIVATE RIGHT OF ACTION AGAINST THE NFA'S MEMBERS.

While not a model of clarity, Petitioners' brief also raises the issue of whether they may bring an implied private right of action against the NFA's *Members* outside of the express right of action found in CEA § 22. 7 U.S.C. § 25. While this claim is not being raised against the NFA itself, (*see* Section I *supra*), the NFA nevertheless believes that a brief response to this argument would assist the Court to dispose of Petitioners' entire *certiorari* petition.

A. No Conflict Exists For This Court To Resolve.

Like the other question presented by Petitioners, this one also involves no conflicts between different United States courts of appeals, a state supreme court or prior decisions of this Court. SUP. CT. R. 10. The only courts to have ruled on the precise issue presented here—whether plaintiffs have an implied private right of action to enforce NFA Bylaw 1101—are the district court and court of appeals below and one district court in the Northern District of Illinois. *See In re Lake States Commodities, Inc.*, 936 F. Supp. 1461, 1469 (N.D. Ill. 1996). All three courts reached the same result: there is no implied private right of action.

Petitioners try to manufacture a conflict by citing to the Second Circuit's holding in *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082 (2d Cir. 1997). *Peltz* did not involve any implied private right of action. It also did not

involve NFA Bylaw 1101. Instead, the plaintiff there sued the defendant FCM under a variety of theories, including willful deceit under CEA § 4b, willful inducement to violate CEA regulations, and state law claims for breach of fiduciary duty, breach of contract and fraud. 115 F.3d at 1086. The Second Circuit interpreted 17 C.F.R. § 166.2 as requiring an FCM to conduct a reasonable inquiry into a designee's authority before making a trade in cases of apparent agency, but not in cases of actual agency. *Id.* at 1089. Because the FCM in that case had actual authority from the designee, the Second Circuit upheld the district court's ruling that the FCM was not liable. *Id. Peltz* cannot create a conflict with the Third Circuit because it dealt entirely with express rights of action authorized by 7 U.S.C. § 25(a)(1).

Petitioners' citation to a 13-year-old ruling in a reparations case before an administrative law judge also fails to create any conflict here. *Acampora v. Prudential Bache Securities, Inc.*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,792 (C.F.T.C. Aug. 31, 1987), was a claim brought by a customer against its FCM under CEA § 14. 7 U.S.C. § 18. The administrative law judge noted in *dicta* that the defendant FCM's failure to register one of its brokers with the CFTC was a violation of the Commodities Exchange Act and "may render them liable for any damages resulting from trading activities during the time they are not registered." *Acampora*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 34,091. Again, the decision did not involve an implied private right of action under NFA Bylaw 1101. The ALJ clearly was referring to the express damages allowed under CEA § 14, 7 U.S.C. § 18(a), in reparation proceedings brought

before the CFTC. This holding therefore does not conflict with the decisions of the district court and court of appeals below, which held that no implied private right of action exists in the courts to enforce violations of NFA Bylaw 1101.

B. The NFA Has Never Endorsed Or Condoned A Private Right Of Action To Enforce Bylaw 1101.

The NFA feels obliged to correct certain misstatements that Petitioners have made about the enforcement of Bylaw 1101. Contrary to Petitioners' contention, the NFA never has admitted a "regulatory intent to allow [a] private right of action to enforce Bylaw 1101." (Pet. at 17.) Petitioners fabricate this "intent" by making the following argument. The NFA's Interpretative Notice to Rule 2-30—NFA's "Know Your Customer" rule—provides that the rule "does not create a private cause of action." (*Id.*) By Petitioners' convoluted logic, "one may, by process of elimination," therefore conclude that the NFA *wanted* plaintiffs to bring private court actions against its Members for violation of any rule or bylaw other than Rule 2-30. (*Id.*) This argument is preposterous.

The NFA never has intended, by its silence, to implicitly sanction a private right of action for violation of nearly all of its rules and bylaws. Such potential liability could bring the NFA to a standstill and prevent the promulgation of rules that are necessary to protect the interests of both the public and its Members. It also would place the NFA's administrative and enforcement priorities in the hands of the judiciary—an untenable result. *Cf. Heckler*, 470 U.S. at 831-32 ("An agency generally cannot act against each technical violation of the

statute it is charged with enforcing. The agency is far better equipped than the courts to deal with the many variables involved in the proper ordering of its priorities.").

The reason that the NFA specifically addressed the private-right-of-action issue in its Interpretive Notice to Rule 2-30 was that some courts already had ruled that similar "Know Your Customer" rules in other states may be actionable. *See, e.g., Buttrey v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135, 141-42 (7th Cir. 1969). Because of such cases, the NFA felt the need to clarify its position. As noted above, however, no court ever has ruled that NFA 1101 or any similar bylaw may create an implied private right of action. That the NFA has not seen fit to expressly disavow such private causes of action in its Interpretive Notices should in no way be taken as a concession that such actions are condoned.[5]

C. This Court Should Not Entertain Petitioners' Request For A New Implied Private Right Of Action.

Since this Court's 1982 decision in *Curran*, where it upheld an implied private right of action under the anti-fraud provisions of the CEA, 456 U.S. at 388, "this Court has long since abandoned its hospitable attitude towards

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[5] Petitioners also argue that because NFA Bylaw 1101 is a "strict liability" offense, an implied private right of action should be recognized. (Pet. at 18.) Petitioners give no explanation, however, for why it should follow that an investor should have an implied right of action under a rule just because the NFA has set a high standard for compliance.

implied rights of action." *Thompson v. Thompson*, 484 U.S. 174, 190 (1988) (Scalia, J., concurring).[6] This is particularly true when Congress already has provided express remedies in the very same statute in which plaintiffs are trying to imply a remedy. *See, e.g., Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 175-77 (1994) (holding that the statutory text controls the conduct prohibited by SEC § 10(b) and that "Congress knew how to impose aiding and abetting liability when it chose to do so," but did not); *Touche Ross & Co. v. Redington*, 442 U.S. 560, 571-72 (1979) (finding no implied cause of action under SEC § 17(a), and reasoning in part that, "when Congress wished to provide a private damage remedy, it knew how to do so and did so expressly").

Ironically, Congress' response to *Curran* was the passage of CEA § 22, which provides exclusive remedies for violations of the CEA in certain limited and specific circumstances. 7 U.S.C. § 25. Petitioners tried vigorously in the district court and the court of appeals to fit themselves within the express remedies provided by CEA § 22; ultimately, they did not succeed. In a final, desperate attempt to circumvent these exclusive remedies in the statute, Petitioners now argue that an implied right of

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[6] The only exception appears to be *Musick, Peeler & Garrett v. Employers Ins.*, 508 U.S. 286, 297-98 (1993), where the Court recognized an implied contribution action under SEC Rule 10b-5. The Court also has assumed that an implied private right of action continues to exist under Title IX of the Civil Rights Act, without actually revisiting the issue. *See Gebser v. Lago Vista Indep. Sch. Dist.*, 524 U.S. 274, 281 (1998); *Franklin v. Gwinnett County Pub. Schs.*, 503 U.S. 60, 65 (1992).

action should be added to this statutory scheme. But Congress' intent is clear: the implied rights that had existed prior to *Curran* have now been superseded by the express remedies afforded in CEA § 22. *See Am. Agric. Movement, Inc. v. Bd. of Trade*, 977 F.2d 1147, 1153 (7th Cir. 1992) ("By its terms, then, § 22(b) creates the exclusive remedies available to those injured by violations of the CEA . . . . The legislative history demonstrates that Congress intended to respond to *Curran* and resolve questions the Court left open.").

No matter how many times Petitioners reference the "public interest" in their petition, the only relevant question for determining whether an implied private right of action exists is a simple one: did Congress intend to imply such a remedy? *See Touche Ross*, 442 U.S. at 578 ("The ultimate question is one of congressional intent, not one of whether this Court thinks that it can improve upon the statutory scheme that Congress enacted into law."). Congress' passage of CEA § 22 mandates that that question be answered in the negative. Because that is exactly what the district court and court of appeals did in this case, there is no need for this Court to intervene.

The cases cited by Petitioners in support of finding an implied private right of action also are inapposite. (Pet. at 16.) Two of those cases actually held that no private right of action exists. *See Colonial Realty Corp. v. Bache & Co.*, 358 F.2d 178, 182-83 (2d Cir. 1966) (no implied right of action for violation of NYSE and NASD rules); *Porter v. Shearson Lehman Bros., Inc.*, 802 F. Supp. 41, 61-63 (S.D. Tex. 1992) (no implied private right of action for violation of NASD "suitability" rule). The one case that did find that a private right of action may exist—the Seventh Circuit's decision in *Buttrey*, 410 F.2d at 141-

42—was decided in 1969 before this Court's and the Seventh Circuit's more recent jurisprudence restricting the right to bring an implied private cause of action. *See, e.g., Indemnified Capital Invs., S.A. v. R.J. O'Brien & Assocs., Inc.*, 12 F.3d 1406, 1412 (7th Cir. 1993) (no implied private right of action for violation of NFA Compliance Rule 2-4); *Spicer v. Chicago Bd. of Options Exch., Inc.*, 977 F.2d 255, 258-66 (7th Cir. 1992) (distinguishing *Buttrey* and refusing to find an implied private right of action against exchanges or market makers for violating or failing to enforce SEC trading rules).

The Court should therefore deny Petitioners' request to review whether an implied private right of action exists under the CEA for violations of NFA Bylaw 1101.

CONCLUSION

The petition for a writ of *certiorari* should be denied.

December 7, 2000

Respectfully submitted,

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No. 00-733

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IN THE

Supreme Court of the United States

RICHARD NICHOLAS, *et alia*,
Petitioners,

v.

SAUL STONE & COMPANY, LLC, *et alia*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF OF RESPONDENT, ROSENTHAL COLLINS GROUP, L.P., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

I. WHETHER THIS COURT SHOULD GRANT A PETITION FOR WRIT OF CERTIORARI WHERE PETITIONERS REQUEST, FOR THE FIRST TIME, THAT THIS COURT CREATE A PRIVATE CAUSE OF ACTION FOR VIOLATIONS OF THE NATIONAL FUTURES ASSOCIATION BYLAW 1101.

II. WHETHER THIS COURT SHOULD GRANT A PETITION FOR WRIT OF CERTIORARI WHERE PETITIONERS HAVE FAILED TO SHOW THAT THE COURT OF APPEALS:

A. HAS ENTERED A DECISION IN CONFLICT WITH ANOTHER U.S COURT OF APPEALS, OR

B. HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW THAT HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

TABLE OF CONTENTS

QUESTIONS PRESENTED FOR REVIEW i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES ii

PRELIMINARY STATEMENT iii

SUMMARY OF ARGUMENT 1

ARGUMENT 2

CONCLUSION 7

TABLE OF AUTHORITIES

Peltz v. SHB Commodities, Inc.
115 F. 3d 1082 (2d Cir.1997) 3

In re Lake States Commodities, Inc.,
936 F. Supp. 1461 (N.D. Ill. 1996) 3

Cort v. Ash,
422 U.S. 66, 95 S. Ct. 2080, 45 L. Ed 2d 26 (1975).....4

PRELIMINARY STATEMENT

Respondent, Rosenthal Collins Group, L.P. ("RCG"), respectfully submits this brief in opposition to the Petition for Writ of Certiorari.

Petitioners present to the Supreme Court two questions regarding the interpretation of the National Futures Association's ("NFA") Bylaw 1101. Petitioners then present three arguments in support of their positions regarding the two questions presented. It is difficult to determine which of the three arguments support which of the two questions presented.

By the first question presented, Petitioners seek to create a private right of action under the Commodities Exchange Act ("CEA") for alleged violation of Section 1101. Respondent, RCG is a member of the NFA as a registered futures commission merchant ("FCM"). Petitioners allege that RCG violated Bylaw 1101 and now seeks to bring an action against RCG based on that violation.

By the second question presented, Petitioners seek to have Bylaw 1101 determined to be an intended requirement of the CEA. As a member FCM has no authority to render an NFA Bylaw as a CEA requirement, Respondent RCG will not address the second question presented nor any arguments in support thereof.

SUMMARY OF ARGUMENT

This Court should not grant a petition for writ of certiorari where Petitioners request, for the first time, that this Court create a private cause of action for violations of the National Futures Association Bylaw 1101. Petitioners did not allege such a claim in either their complaint or their amended complaint. They did not raise it at any proceeding before the District Court or the Court of Appeals below. They should not be allowed to raise the issue at this point.

Furthermore, this Court should not grant a Petition for Writ of Certiorari where Petitioners have failed to show that the Court of Appeals: (a) has entered a decision in conflict with another U.S. Court of Appeals or (b) has decided an important question of federal law that has not been, but should be, settled by this court. There is no conflict between the Circuits regarding a private right of action under Bylaw 1101. The question of whether a private right of action under Bylaw 1101 is not an important question of federal law, where §25 of the CEA creates exclusive remedies for violations of the act.

ARGUMENT

I. THIS COURT SHOULD NOT GRANT A PETITION FOR WRIT OF CERTIORARI WHERE PETITIONERS REQUEST, FOR THE FIRST TIME, THAT THIS COURT CREATE A PRIVATE CAUSE OF ACTION FOR VIOLATIONS OF THE NATIONAL FUTURES ASSOCIATION BYLAW 1101.

Petitioners, in their complaints before the District Court, did not allege a violation by any Respondent of NFA Bylaw 1101. Instead Count 2 of the complaint and amended complaint alleged a breach of contract between the FCM Respondents and Respondent, NFA. Petitioners sought relief from the District Court as third party beneficiaries of the contract between the FCM Respondents and the NFA.

The District Court found that "there is simply no indication in the instant case that plaintiffs were the intended beneficiaries of the contractual relationship between the NFA and its FCM members" P.A. 66a. The District Court stated that because there was "no indication that the NFA and its members intended to bestow *contractual rights* on the public under the NFA Manual and Bylaws ... Count 2 of Plaintiffs' Amended Complaint *alleging breach of contract* will be dismissed." (Emphasis added) P.A. 67a-68a.

The Court of Appeals did not discuss Petitioners' claims under Count 2. Instead, they found that the claims including "breach of contract" were discussed by the District Court and found the discussion "cogent and persuasive" and therefore adopted the District Court conclusions with respect to those issues. P.A. 29a-30a.

Before this Court, Petitioners have abandoned their breach of contract claim involving NFA Bylaw 1101 and instead have proposed, for the very first time, a private right

of action under the rule. Neither the complaint nor the amended complaint alleges a right of action under Bylaw 1101. Petitioners did not raise this issue at any point during the proceedings before the District Court. They did not raise this issue before the Court of Appeals. This issue has not been raised nor developed at any point until the Petition for Writ of Certiorari. This Court should not grant certiorari to any issue raised for the first time in a petition for a writ.

II. THIS COURT SHOULD NOT GRANT A PETITION FOR WRIT OF CERTIORARI WHERE PETITIONERS HAVE FAILED TO SHOW THAT THE COURT OF APPEALS HAS ENTERED A DECISION IN CONFLICT WITH ANOTHER U.S. COURT OF APPEALS.

Petitioners claim that the courts are divided on the right of a private investor to pursue a cause of action for a violation of Bylaw 1101. P.A. 13. Petitioners cite *Peltz v. SHB Commodities, Inc.* 115 F. 3d 1082 (2d Cir. 1997) as a case in opposition to the lower Court of Appeals in this case. However, the *Peltz* court does not address Bylaw 1101. The plaintiff in *Peltz* had been involved in a scheme to defraud the markets, which failed and caused a debit in his account at defendant, FCM. Plaintiff charged that defendant had not properly secured the authorization for the trading in his account under 17 C.F.R. § 166.2. The *Peltz* court found that the defendant had complied with the regulation and affirmed the trial courts decision for defendant. At no time, did the plaintiff raise a right of action under Bylaw 1101, nor did the *Peltz* court address the issue. Therefore, the *Peltz* decision is not in conflict with the lower Court of Appeals' decision.

Petitioners accurately state that the District Court for the Northern District of Illinois, Eastern Division declined to imply a private right of action for violations of Bylaw 1101

in *In re Lake States Commodities, Inc.*, 936 F. Supp. 1461 (N.D. Ill. 1996). P.A. 14. This citation, however, does not support their position that the U.S. Courts of Appeals are in conflict regarding a private right of action under Bylaw 1101.

Finally, Petitioners state that there is a conflict between the regulatory bodies, *i.e.* NFA and CFTC, and the courts. P.A. 15. This bald statement seems incongruous to Petitioners' instant claim against the NFA for failure to recognize a private right of action for the violation of Rule 1101. Certainly, the NFA is not in conflict with the lower courts' decisions. Respondent is at a loss to explain this apparent contradiction.

Petitioners have failed to demonstrate that the 3rd Circuit's decision is in conflict with another Court of Appeals. For this reason, their petition should be denied.

III. THIS COURT SHOULD NOT GRANT A PETITION FOR WRIT OF CERTIORARI WHERE PETITIONERS HAVE FAILED TO SHOW THAT THE COURT OF APPEALS HAS DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW THAT HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

Petitioners have not specifically cited Supreme Court Rule 10(c) as a basis for its Petition for Writ of Certiorari. However, it is the only basis that can be inferred from their arguments entitled I.B.2. and I.C.

Argument I.B.2. states that Bylaw 1101 is a specific rule for the protection of the public. P.A. 18. In support of this argument, Petitioner cites *Cort v. Ash*, 422 U.S. 66, 95 S. Ct. 2080, 45 L. Ed 2d 26 (1975). Petitioners correctly state

that the *Cort* decision "sets forth four factors to be considered when determining the existence of a private right of action under a federal statute which does not provide for one." P.A. 19. The *Cort* decision set forth several relevant factors to determine whether a private remedy is implicit in a statute not expressly providing one. The CEA, from which Petitioners seek relief, does, however, expressly provide public remedies.

Petitioners entreat this Court to "revisit" the *Cort* decision. P.A. 20. The reason for this revisit is to provide the public benefit of preventing fraud. Certainly, a worthy reason that could be an important federal question to be decided by this Court, if it were not for the private rights of action section already in place in §25 of the CEA.

Sections 25(a) and 25(b) of the CEA provide the "exclusive remed [ies]" for violations of the CEA. Section 25(a)(2) states:

> "Except as provided in subsection (b) of this section, the rights of action authorized by this subsection and by sections 7a(11), 18, and 21 (b)(10) of this title shall be the *exclusive remedies* under this chapter available to any person who sustains loss as a result of any alleged violation of this chapter. Nothing in this subsection shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims under this section, including arbitration." (Emphasis Added.)

Section 25(b) 5 states:

> "The rights of action authorized by this subsection shall be the *exclusive remedy* under this chapter available to any person who sustains a loss as a result of (A) the alleged failure by a contract market, licensed

> board of trade, clearing organization, or registered futures association or by any officer, director, governor, committee member, or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution referred to in this subsection that is alleged to have violated this chapter, or any Commission rule, regulation, or order." (Emphasis Added.)

Again, Petitioners cite authority that does not support their position. Section 25 clearly provides for exclusive rights of action. Therefore, this Court should not carve out another right of action from the CEA by way of Bylaw 1101.

Finally, Petitioners argue that this Court needs to recognize a private right of action under Bylaw 1101 to protect the public from Ponzi schemes and types of other commodity fraud. P.A. 10, 21.This last-ditch effort to dress up their argument as an important question of federal law also fails.

Petitioners state in their Factual Background that the Ponzi scheme at issue was designed and executed by one Charles Kohli and Ram Chandran. P.A. 7. Kohli plead guilty to federal charges of commodities fraud, wire fraud and income tax evasion. P.A. 40a. Chandran is under investigation by the United States Attorney's Office. P.A. 41a. Clearly, the designers and executors of the scheme perpetrated against Petitioners have been brought to justice. To seek civil remedies for their injuries, Petitioners need only look to §25 of the CEA. Petitioners have failed to show how the public needs an additional right of action to protect it from Ponzi schemes and other commodity fraud.

CONCLUSION

Petitioners request, for the first time, that this Court create a private cause of action for violations of the National Futures Association Bylaw 1101. However, they have failed to present any special and important reason to compel review by this Court.

Furthermore, Petitioners have failed to articulate a proper question for this Court to consider under Supreme Court Rule 10. Petitioners have failed to show that the Court of Appeals has (a) entered a decision in conflict with another U.S Court of Appeals or (b) has decided an important question of federal law that has not been, but should be, settled by this Court.

Accordingly, for all the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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December 7, 2000

(6)

Supreme Court, U.S.
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No. 00-733

In The

Supreme Court of the United States

RICHARD NICHOLAS, et al.,

Petitioners,

v.

SAUL STONE & COMPANY, LLC, et al.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

PETITIONERS' REPLY TO BRIEFS IN OPPOSITION

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QUESTIONS PRESENTED

In this case, the District Court for the District of New Jersey held, in relevant part, as follows: (i) that the Petitioners do not have a private remedy for violations of National Futures Association ("NFA") bylaws and rules, in particular NFA Bylaw 1101 – the NFA's "cornerstone" of self-regulation for the *protection of the public interest*; and, (ii) that the NFA may not be held liable pursuant to 7 U.S.C. §25(b)(2) unless it fails to enforce a bylaw or rule required under 7 U.S.C. §21 and determined, further, that NFA Bylaw 1101 is not such a required bylaw. The Third Circuit Court of Appeals, without specific reference or discussion, adopted the conclusions reached by the District Court with respect to each of these issues. The questions presented are:

1. Do investors in commodities futures contracts have a private cause of action against NFA Members for damages resulting from violations of NFA Bylaw 1101?

2. Is NFA Bylaw 1101 an intended requirement of the Commodity Exchange Act ("CEA")?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iii

SUPPLEMENTAL STATEMENT OF THE CASE 1

A. The Questions Presented Were Raised Below 1

REASONS FOR GRANTING THE PETITION 3

ARGUMENT I:

THE SUPREME COURT SHOULD RESOLVE THE CONFLICT OVER NFA BYLAW 1101 IN FAVOR OF A PRIVATE CAUSE OF ACTION 4

A. Investors Are Entitled To A Private Cause Of Action For Damages Resulting From Violations Of NFA Bylaw 1101 6

1. NFA Bylaw 1101 Is A Specific Rule For The Public's Protection 6

ARGUMENT II:

NFA BYLAW 1101 IS A REQUIRED RULE PURSUANT TO THE STATUTORY INTERPRETATION OF 7 U.S.C. §21 8

A. Investors Are Entitled To A Private Cause Of Action Against The NFA Pursuant To 7 U.S.C. §25(b) 8

CONCLUSION 10

TABLE OF AUTHORITIES

Pages

CASES

American Agriculture Movement v. Bd. of Trade, 977 F.2d 1147 (7th Cir. 1992) 8

Cardoza v. CFTC, 768 F.2d 1542 (7th Cir. 1985) 8

Hormel v. Helvering, 312 U.S. 552 (1941) 3

Idahoan Fresh v. Advantage Produce, Inc., 157 F.3d 197 (3d Cir. 1998) 10

J.I. Case Co. v. Borak, 377 U.S. 426 (1964) 3, 6

Koppel v. 4987 Corporation, 167 F.3d 125 (2d Cir. 1999) 3, 6, 7, 8

Matter of Lake States Commodities, Inc., 936 F. Supp. 1461 (N.D. Ill., E.D. 1996) 3

Peltz v. SHB Commodities, Inc., 115 F.3d 1082 (2d Cir. 1997) ..... *passim*

Sansom Refining Co. v. Drexel Burnham Lambert, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶¶ 23,796 at 34,107, (CFTC July 20, 1987), aff'd. in part, rev'd. in part and remanded sub nom. *Drexel Burnham Lambert, Inc., v. CFTC*, 850 F.2d 742 (D.C. Cir. 1988) 4, 5

Sola Electric Co. v. Jefferson Electric Co., 317 U.S. 73 (1942) 6

State (N.J.) v. Ercolano, A-6729-98T3 (N.J. Super., App. Div. 11/28/00) 10

Stevens v. Dept. of Treasury, 500 U.S. 1 (1991) 1

Tenneco Oil Co. v. Dept. of Energy, 475 F. Supp. 299 (1979) 3

Youakim v. Miller, 425 U.S. 231 (1976) 1

TABLE OF AUTHORITIES – Continued

Pages

United States v. Williams, 504 U.S. 36 (1992) 1

Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991) 3, 6, 7

STATUTES

7 U.S.C. §5 7

7 U.S.C. §6d 2

7 U.S.C. §6e 2

7 U.S.C. §6k 2

7 U.S.C. §6n 2

7 U.S.C. §21 ..... *passim*

7 U.S.C. §21(b) 4, 10

7 U.S.C. §21(b)(1) 7, 9

7 U.S.C. §21(b)(2) 4, 9, 10

7 U.S.C. §21(m) ..... *passim*

7 U.S.C. §21(p)(3) 5

7 U.S.C. §25(a) 7

7 U.S.C. §25(b) 8

7 U.S.C. §25(b)(2) ..... i, 4

17 CFR §166.2 ..... *passim*

17 CFR §166.2(a) 4

17 CFR §166.2(b) 4

TABLE OF AUTHORITIES – Continued

Pages

REGULATIONS AND RULES

U.S. Supreme Court Rule 10(a).....3, 4

U.S. Supreme Court Rule 10(c).....3, 4

NFA Bylaw 1101..... *passim*

NFA Compliance Rule 2-8 ..... *passim*

NFA Compliance Rule 2-8(e)..... 2, 5, 6

NFA Compliance Rule 2-30 2

OTHER AUTHORITIES

Futures Trading Act of 1982, Pub.L. 97-444 House Report No. 97-565, Part I, page 57..... 8

S. Rep. No. 650, 95th Cong., 2d Session 31 (1978) 9

NFA Articles of Incorporation, Article III, §1(a), Public Interest purpose 7

NFA Articles of Incorporation, Article III, §1(f), Public Interest purpose 8, 9

¶9001, NFA Interpretive Notices, NFA Compliance Rule(s) 2-8, etc. (January 31, 1985)..... 5

¶9007, NFA Interpretive Notices, Compliance With NFA Bylaw 1101 (Staff, March 19, 1987)....5, 7

SUPPLEMENTAL STATEMENT OF THE CASE

A. The Questions Presented Were Raised Below

The traditional United States Supreme Court rule precludes a grant of Certiorari only when "the question was not *pressed or passed upon below* (emphasis added). The rule operates in the disjunctive, permitting review of an issue not pressed so long as it has been passed upon. *United States v. Williams*, 504 U.S. 36, 41 (1992), citing *Stevens v. Dept. of Treasury*, 500 U.S. 1, 8 (1991). Further, this Court can exercise discretion to review an important issue expressly decided by a Federal Court. *United States v. Williams*, 504 U.S. supra, at 45 [fn. 5]. See also, *Youakim v. Miller*, 425 U.S. 231, 234 (1976).

The first Question Presented concerning a private cause of action against futures commission merchants ("FCM" or collectively "FCMs") for violations of the National Futures Association ("NFA") Bylaw 1101 was raised below as follows:

(a) *The District Court for the District of New Jersey* –

- *First Amended Complaint ("Complaint")*, Claim I, ¶ 135 (R.A.,[1] 52a), Claim II, ¶¶ 136 through 146 (R.A., 54a-57a);
- *Brief In Support Of The Motion To Dismiss*, filed by Respondents, Saul Stone & Company LLC, et al., II, A, "Count II Fails To State A Claim For Breach Of Contract, 1. No Private Cause Of Action Exists For Violation Of NFA Rules."
- *Brief In Support Of The Motion To Dismiss*, filed by Respondent, Merrill Lynch, Pierce, Fenner & Smith Inc., suggests that a claim by a third party beneficiary [customer] for breach of contract between NFA and its Member(s) is akin to a private right of

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[1] Citations to "R.A." are to the Appendix attached to Respondent, Merrill Lynch, Pierce, Fenner & Smith Inc.'s Opposition Brief.

action for violation of NFA rules.[2] POINT I, D, at pages 21 and 22 thereof.

- *Petitioners' Opposition Briefs To Motions To Dismiss,* POINT I, E, "NFA Bylaw 1101 Is Nothing More Than The Statutory Makeup Of The CEA, 7 U.S.C. §§6d, 6e, 6k and 6n And Failure To Abide By The Bylaw Is Actionable Against The FCM Defendants;" and, POINT I, B, "Plaintiffs Claim For A Private Cause Of Action For Violations Of NFA Bylaw 1101 And NFA Compliance Rule 2-30 Is Proper And Not Frivolous."

(b) *The Third Circuit Court of Appeals* –

- *Petitioners' Brief, re: Issues Presented For Review,* Issue "5. Whether Plaintiffs are allowed to bring a private cause of action for violation of NFA Bylaw 1101 (inclusive of NFA Compliance Rule 2-8(e)) and NFA Compliance Rule 2-30." POINT I, D, pages 26-33 of Petitioners' Brief.
- *Respondent, Saul Stone & Company LLC's Brief,* II, A, 1 (page 41), "No Private Cause of Action Exists For Violation Of NFA Rules."
- *Respondents', Merrill Lynch, Pierce, Fenner & Smith Inc. Brief,* POINT I, C (page 32), "No Private Right Of Action Exists For Violation Of §1101 Of The NFA By-Laws."

The District Court Opinion addresses the issue of an implied private cause of action regarding NFA Bylaw 1101, specifically at Pet. App. 69a-70a and generally at Pet. App. 63a-67a, relating to Claim II of the Complaint.

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[2] The CFTC noted at page 28 of the Order Granting [NFA] Registration And Approving Rules (1981), "Moreover, . . . , the Commission believes it is appropriate in the public interest to assess the costs of such regulation directly upon the industry and *customer beneficiaries* (emphasis added) of NFA regulation. . . . "

The Third Circuit adopted the conclusions reached by the District Court. Pet. App. 29a-30a.[3]

Notwithstanding that the *Questions Presented were raised and passed upon below*, there may always be exceptional circumstances that prompt an appellate court, where injustice might otherwise result, to consider questions of law not passed upon by the court below. *Tenneco Oil Co. v. Dept. of Energy*, 475 F. Supp. 299, 304 (1979); citing *Hormel v. Helvering*, 312 U.S. 552 (1941).

REASONS FOR GRANTING THE PETITION

(a) A conflict absolutely exists between the Second and Third Circuits regarding a private cause of action for the failure of an NFA Member to abide by NFA Bylaw 1101, see infra, at 4. Further, in the *Matter of Lake States Commodities, Inc.*, 936 F. Supp. 1461, 1469 (N.D. Il., E.D. 1996), the District Court looked to plaintiffs to offer more persuasive support for a different outcome. Pet.[4] 14-15. Indeed, the right to a private cause of action for a violation of NFA Bylaw 1101 is an important federal question because this rule is the cornerstone of the NFA's obligation to fulfill the purpose of the CEA. Reference is made to U.S. Supreme Court Rules 10(a) and 10(c).

(b) The Second Circuit's decision in *Koppel v. 4987 Corporation*, 167 F.3d 125 (2d Cir. 1999) infra, at 6, is consistent with this Court's Opinion in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964) infra, at 6, yet a departure from the decision of *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991) infra, at 6. The *Koppel* decision granted a private cause of action with reasons supporting such an outcome. Reference is made to U.S. Supreme Court Rules

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[3] The Respondent, NFA does not argue in its Opposition Brief to the Petition that the second Question Presented in the Petition was not raised below. Citations "Pet. App." Are to the Appendix attached to the Petition.

[4] The Petition is referred to herein as "Pet."

10(a), conflicting decisions, and (c), conflicting decisions with decisions of this Court.

(c) The statutory interpretation of 7 U.S.C. §§21(m) and 21(b) – in particular, the word MAY as mandatory, resulting in a *required mandatory membership rule* under 7 U.S.C. §25(b)(2). Reference is made to U.S. Supreme Court Rule 10(c), due to the inability to achieve congressional purpose of the CEA without the required rule; the Petition raises an important federal question.

ARGUMENT I:

THE SUPREME COURT SHOULD RESOLVE THE CONFLICT OVER NFA BYLAW 1101 IN FAVOR OF A PRIVATE CAUSE OF ACTION

Respondents' Briefs lead this Court to believe a conflict does not exist between the Third Circuit and the Second Circuit. In so doing, Respondents focus on *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082 (2d Cir. 1997).[5] Plaintiff in *Peltz* charged defendant, SHB, had not properly secured trading authorization under 17 C.F.R. §166.2.[6] Before accepting trades from a third party, the FCM must make a reasonable inquiry into the nature and extent of the individual's authority. *Peltz v. SHB Commodities, Inc.*, 115 F.3d 1082 supra, citing *Sansom Refining Co. v. Drexel Burnham Lambert, Inc.*, [1986-1987 Transfer Binder] Comm.

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[5] Peltz was an investor in commodities who maintained an account at SHB Commodities, Inc. ("SHB"), an FCM. Weingraten was a floor broker and was never employed by SHB. Weingarten advised an employee of SHB that he would be "doing paper" for Peltz that day. Peltz suffered substantial losses and SHB issued a margin call against Peltz' account at SHB, which Peltz could not meet.

[6] An FCM may execute trades for a customer only after the customer or someone designated by the customer to control the account "specifically authorize[s]" the trades under §§166.2(a), or provides the FCM with written authorization for the trades under 166.2(b).

Fut. L. Rep. (CCH) ¶¶ 23,796 at 34,107, 34,108 (CFTC July 20, 1987), aff'd. in part, rev'd. in part and remanded sub nom. *Drexel Burnham Lambert, Inc., v. CFTC*, 850 F.2d 742 (D.C. Cir. 1988).

In relevant part, 17 C.F.R. §166.2 includes the Third Party Account Controller rule under which the FCM must inquire as to a third party's authority to trade on behalf of a customer. Consistent with §166.2 the NFA promulgated and the Commodity Futures Trading Commission ("CFTC") approved NFA Compliance Rule 2-8(e), "Third Party Account Controller" to impose certain requirements on FCMs who carry discretionary accounts controlled by third parties. However, the FCM remains responsible for compliance with NFA Bylaw 1101.[7]

NFA Compliance Rule 2-8(e) provides an additional check in the regulatory scheme. ¶ 9001, NFA Interpretive Notices, NFA Compliance Rule(s) *2-8*, etc. (January 31, 1985).[8] According to the NFA, " . . . there are certain minimal steps which should be taken to reduce the possibility of a violation of NFA Bylaw 1101: . . . 4., which requires an NFA Member to meet the standards set forth in NFA Compliance Rule 2-8(e)." Pet. App. 149a.[9] Clearly NFA Bylaw 1101 and NFA Compliance Rule 2-8(e) *overlap*. Therefore, on February 19, 1998 the NFA approved a resolution to delete NFA Compliance Rule 2-8(e)(2). The NFA took this action because 2-8(e)(2) duplicates regulatory protections afforded by NFA Bylaw 1101.

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[7] ¶ 9001, NFA Interpretive Notices, NFA Compliance Rules 2-8, etc. (January 31, 1985).

[8] 7 U.S.C. §21(p)(3) of the Commodity Exchange Act ("CEA") *requires* (emphasis added) that NFA "establish minimum standards governing the sales practices of its members and persons associated therewith." NFA has established such minimum standard in the form of its Compliance Rules. ¶ 9001, NFA Interpretive Notices, NFA Compliance Rule(s) *2-8*, etc., (January 31, 1985).

[9] ¶ 9007, NFA Interpretive Notices, Compliance With NFA Bylaw 1101 (Staff, March 19, 1987). Pet. App. 147a.

NFA Compliance Rule 2-8(e) was approved in accordance with the substantive requirements of 17 C.F.R. §166.2. It therefore follows that *Peltz* was decided on the *same principles as NFA Bylaw 1101,* which affords customer protection inclusive of NFA Compliance Rule 2-8(e)(2) regarding the activities of a Third Party Account Controller.

The Respondents' argument that *Peltz* did not involve NFA Bylaw 1101 ignores the common and practical sense of the Second Circuit's decision as well as the NFA's determination that Rule 2-8(e)(2) is not necessary, as *its protections are covered by NFA Bylaw 1101.*

A. Investors Are Entitled To A Private Cause Of Action For Damages Resulting From Violations Of NFA Bylaw 1101

1. NFA Bylaw 1101 Is A Specific Rule For The Public's Protection

In *J.I. Case Co. v. Borak,* 377 U.S. 426, 432 (1964), this Court found an implied private right of action under SEC rules. While the statutory language makes no specific reference to a private cause of action, among its chief purposes is "the protection of investors." "Under the circumstances . . . it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *J.I. Case Co. v. Borak,* 377 U.S. supra, at 433; citing *Sola Electric Co. v. Jefferson Electric Co.,* 317 U.S. 173, 176 (1942).

The Second Circuit Court of Appeals in *Koppel v. 4987 Corporation,* 167 F.3d 125 (2d Cir. 1999) decided in favor of a private cause of action on similar facts and circumstances to the *Borak* case, supra, notwithstanding the earlier Supreme Court's decision of *Virginia Bankshares, Inc. v. Sandberg,* 501 U.S. 1083 (1991). The congressional intent in both *Borak* and *Koppel* "stemmed from the congressional belief that 'fair corporate suffrage is an important right . . . ', [and i]t was intended to control the conditions . . . to preventing the recurrence of abuses. . . . " 167 F.3d at 135, citing 377 U.S. at 431. Likewise, in the case at

bar the public interest is at the heart of the statutory scheme,

> "From the earliest stages of its formation, NFA's founders recognized that the creation of a meaningful and effective industry wide self-regulatory organization would be completely impossible unless all persons required to be registered . . . were required to be Members." Pet. App. 147a.

7 U.S.C. §5 renders regulation imperative to protect interstate commerce and the national public interest, while 7 U.S.C. §21(b)(1) prohibits the CFTC from registering a futures association unless it is able to find that it is in the public interest. Pet. App. 100a. See also Pet. App. 144a, NFA Articles of Incorporation, Article III, §1(a) Public Interest purpose.

Further, as noted in both *Virginia Bankshares*, 501 U.S. supra, at 1104-05, and *Koppel*, 167 F.3d supra, at 136, the judiciary looks to policy reasons for deciding where the outer limits of the implied right of action should lie. Like the SEC in those cases, the CFTC herein favors private rights of action. "Given the limited resources of the government, private rights of action are an important supplement to government enforcement actions in helping to ensure lawful conduct in the commodities industry." Pet. App. 135a.[10] Furthermore, "The right of an aggrieved person to sue a violator of the CEA is critical to protecting the public and fundamental to maintaining the credibility of the futures market." Pet. App. 183a.[11]

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[10] Where the NFA refuses to enforce its Bylaw 1101 the only recourse is to allow a private cause of action similar to judicial review of the standard of criteria set forth in ¶ 9007, NFA Interpretive Notice, *Compliance With Bylaw 1101*, as a court may do pursuant to the Administrative Procedures Act. See Pet. Argument III, page 25.

[11] The purpose of restrictions of 7 U.S.C. §25(a) is to avoid suits for speculative damages. Such is not so in the case at bar,

ARGUMENT II:

NFA BYLAW 1101 IS A REQUIRED RULE PURSUANT TO THE STATUTORY INTERPRETATION OF 7 U.S.C §21

A. Investors Are Entitled To A Private Cause Of Action Against The NFA Pursuant To 7 U.S.C. §25(b)

On January 31, 1977, the NFA organizers submitted its initial proposal of Articles of Incorporation to the CFTC, seeking registration as a §21 registered futures association ("RFA").[12] The Articles of Incorporation, §III,(1)(g)[13] specify one of the two purposes of the NFA to be "[t]o prohibit any member from carrying accounts or from handling transactions in commodity futures contracts or commodity options on behalf of a non-member acting in respect to such accounts or transactions as a FCM, CPO, ..." This was the required provision for eventual NFA approval as an RFA and makes NFA membership mandatory. Approved as Article III, §(1)(f).

A thorough review of 7 U.S.C. §21, without §21(m), causes one to conclude, as did the Department of Justice in 1977, that the statutory intent, in particular subsections (b)(2), (d) and (e), was to make membership in an RFA

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which is the result of transactions on the market. Futures Trading Act of 1982, Pub. L. 97-444; House Report No. 97-565, Part I, pages 56-57. Pet. App. 184a. See also *Koppel*, 167 F.3d supra, at 137. In a number of instances, the basis for disallowing a private right of action was due to the speculative nature of non-trader issues (see *American Agriculture Movement v. Bd. of Trade*, 977 F.2d 1147 (7th Cir. 1992)) and membership disputes (see *Cardoza v. CFTC*, 678 F.2d 1542 (7th Cir. 1985)), both of which do not come within the remedial intent of the CEA.

[12] Comments of the U.S. Department of Justice were issued on October 7, 1977 In The Matter Of The National Futures Association ("October 7, 1977 Application").

[13] October 7, 1977 Application, page 26.

voluntary, not mandatory. The Department of Justice determined that for the CFTC to then find scope for compulsory membership in §21 is to simply engage in legislation on its own. October 7, 1977 Application, page 43. The aforesaid was the compelling reason for the enactment of 7 U.S.C §21(m), thereby settling the question whether the CFTC has the authority to register an RFA, requiring mandatory membership, in addition to achieving the least anti-competitive means for compulsory membership.[14]

In either case, Congress determined it was necessary and an RFA would not have been approved by the CFTC without a rule requiring membership. For without such a requirement the RFA would not appear capable of fulfilling the CEA's purposes, "that such association is in the public interest." 7 U.S.C. §21(b)(1). Therefore, 7 U.S.C. §21 was amended to allow for compulsory membership.

The NFA is the first and only RFA. As part of its initial registration approval and for all times thereafter, "[T]he founders of NFA considered the issue to be of such critical importance that they not only prohibited the conduct of customer business with non-Members through NFA Bylaw 1101, but included that prohibition as one of NFA's fundamental purposes in Article III, Section 1(f) of NFA's Articles of Incorporation." Pet. App. 147a.

NFA's compulsory membership has rendered the language of 7 U.S.C. §21(b)(2), whereby any person eligible for membership *may* become a member of the RFA (Pet.

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[14] Such is the statement of purpose in order to provide mandatory membership in RFA in order to achieve the regulatory scheme and protect the public interest. Pet. App. 111a. By enacting §21(m), Congress took note that:

> "This objective [of effective self-regulation] would be frustrated if futures industry professionals were free to discontinue their membership, . . . , when their own acts and practices came under scrutiny or investigation . . . ." S. Rep. No. 650, 95th Cong., 2d Session 31 (1978) at Pet. App. 112a.

App. 155a), ineffective. Therefore, the only logical reading of the CEA is to interpret MAY in §21(b) and in §21(m) as SHALL. In fact, every requirement under 7 U.S.C. §21(b) 1-13 inclusive, *derives its meaning from required membership in an RFA*. As such, §21 cannot survive without 7 U.S.C. §21(m)[15] and, thus, NFA Bylaw 1101 must be deemed *a required Bylaw*. To do otherwise would not give meaning to all provisions.

The basic tenet of statutory construction applies equally to the interpretation of regulations, i.e., 17 C.F.R. §166.2 [and rules, NFA Bylaw 1101]. The preferred statutory and regulatory construction is one that gives meaning to all provisions. Unless the word MAY in §21(b)(2) is read as SHALL a conflict will exist between this statute and NFA Bylaw 1101. *Idahoan Fresh v. Advantage Produce, Inc.*, 157 F.3d 197, 202 (3d Cir. 1998). "Where a literal rendering [of a statute] will lead to a result not in accord with [its] essential purpose and design . . . , the spirit of the law will control the letter." *State (N.J.) v. Ercolano*, A-6729-98T3 (N.J. Super., App. Div. 11/28/00).

CONCLUSION

For the reasons set forth hereinabove and in addition to the Petition, Petitioners respectfully request that the Petition for Writ of Certiorari be granted.

Respectfully submitted,

EDWARD M. BERNSTEIN, ESQUIRE,
Counsel of Record

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[15] Requiring membership in an RFA is an essential factor in providing the effective, industry-wide customer protection that the NFA proposes. If membership were purely voluntary, those engaging in abusive practices could evade self-regulatory compliance. Pet. App. 114a.